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## **1. Project Brief**

This report was commissioned by Farming Connect via the Organic Centre Wales and was written and produced by the Soil Association Producer Services Department in February 2003. It has been made possible with the kind co-operation of the Federation of Milk Groups.

### Objectives

1. To develop a system of monthly data collection for Wales which is compatible with nation-wide data collection
2. Collection of historic data on dairy production in Wales (1997 – 2002)
3. Projections for future production and processing levels (2003 – 2006)
4. Identification of potential areas of growth

### Soil Association Producer Services

A key part of the Soil Association's work is the production of the Organic Food and Farming Report which is a national assessment of developments in the organic sector. In compiling the report the association has established a reputation as a key provider of national statistics on production, processing and marketing of organic products. Increasingly Soil Association Producer Services is producing regional and enterprise specific marketing intelligence reports.

## 2. Background

The organic retail market increased in value by 15% between April 2001 and April 2002, and is predicted to increase by a further 9% by April 2003 to be approximately £1billion. This represents a slowing of the rate of growth, but still a significant increase in a market of this size, and potentially a consolidation and steadying of the organic market. (Organic Food and Farming Report 2002)

According to the report to the Milk Development Council (MDC report), in terms of volume, organic milk utilisation has increased steadily and at a faster rate than the overall organic market. Between April 2001 and 2002 it increased by 48% from 92.8 to 137.3 million litres and at that time the rate of increase was not slowing but slightly increasing (it had grown by 44% the previous year). This project has identified current market expansion at approximately 20% per year.

During 2001 / 2002 one of the few things to grow faster than the organic dairy market was the production level of organic milk. This growth was triggered two years earlier in 1999 / 2000 by Organic Farming Scheme payments combined with a very favourable organic milk price of 29.5p / litre with a commitment from some customers to buy at this price for 5 years. This was against a background of poor and dropping conventional milk price at that time of around 15 – 16 p / litre.

The delay caused by a two-year conversion period means that the increase in organic production takes two years to be realised. It is not surprising that, without accurate market information, milk buyers and farmers found themselves in a situation of uncontrolled oversupply and therefore collapsing price to farmers. This switch from under-supply to over-supply happened in the spring of 2001. Due to the fact that organic farmers who have received OFS are contracted to remain in organic certification for 5 years, and farmers in conversion are still coming on-line, there has been no easy way for the production of organic milk to be reduced quickly.

Hence the clear need for this project, because, given the conversion period and contractual nature of the OFS, dairy farm conversion needs to be planned based on good market intelligence, and projections at least 2 – 3 years ahead. Farmers need to plan their conversion this far ahead with milk groups, and contracts secured before conversion is undertaken.

In terms of total UK organic milk production, England produces the majority (83%); however Wales accounts for 14% and is the region showing the greatest rate of increase in organic dairy production (MDC). According to the MDC there were only 30 organic producers in Wales in April 1999, however capacity grew rapidly during 2000 and 2001, and by April 2002 there were roughly 150 organic farms in the region. The proportion of organic dairy producers in Wales is now similar to the UK as a whole.

### **3. Methodology**

#### **3.1 Developing a system for data collection**

The organic dairy industry has suffered from a lack of forward planning that has contributed in the current crisis. With hindsight it is possible that the current situation could have been avoided with more intelligence and communication between milk groups, sector bodies and policy makers.

In terms of market intelligence it is important to be able to access accurate historic, current and projected data which is as comprehensive as possible. Most importantly we need to know as accurately as possible the following:

- 1) The current national production of organic milk and the current trend over time.
- 2) The current demand for organic milk and the current trend over time.
- 3) The potential current and future capacity to produce organic milk which means knowing the number of farmers in conversion and currently the number of organic farms with non-organic herds.
- 4) In addition any known factors that will affect future supply and demand.

In addition to all of the above it is useful to analyse the industry in terms of specific key product areas and regional aspects which can help to identify potential for growth and the need for support and development in particular areas.

#### **Information available**

The information that was available at the time this project started came from various sources.

The Soil Association had been involved in producing the MDC report "Market Prospects for Organic Milk". Although the raw data that was used for this report was not available, the report itself was comprehensive and extensive and so information that is relevant to Wales from this project has been directly quoted.

The Soil Association also annually produces the Organic Food and Farming Report and the quarterly Organic Farming Magazine carries an "Eye on the Market" section; these have been quoted.

The problem with these sources of information is that they relied on voluntary surveys sent out by the Soil Association to milk groups and processors. The response rate was not 100%, consequently assumptions had to be made.

Further to this the Soil Association was kindly provided with information on the number and area of organic dairy farms by SA Cert and OF&G.

### **Additional information required**

The main problem with the systems identified above was that most data was collected annually at best, which certainly is not sensitive enough to identify important aspects of the current supply and demand situation and make predictions that are needed for business planning in the current crisis. Moreover the difficulty in obtaining response from all groups meant that data collection was incomplete and assumptions had to be made. There was a need for a more formal and efficient system and a more regular (preferably monthly) data collection system.

### **Federation of Milk Groups**

Following discussions with a number of milk groups it became apparent that the Federation of Milk Groups already collects national organic milk production figures of the milk that is handled by the co-ops and milk groups. They were therefore approached with a view to sharing information with the Soil Association to improve market intelligence and co-ordination.

At a preliminary meeting it was identified that the major concern about releasing this information was that it might be used irresponsibly by certification bodies and others to promote organic conversion thus perpetuating the current problems of market supply. However it was agreed that it was in no-one's interest to use information in this way and that by working together and using information responsibly the aims of both the FMG and the Soil Association to restore stability within the organic dairy sector could be achieved more quickly.

It was also identified at this meeting that the information currently collected by the FMG was very limited, being a monthly total volume of UK organic milk, and a 12-month forecast. Information on what is actually sold into the organic sector (and therefore the surplus sold into the conventional market) was not collected, nor was there any regional breakdown or information on utilisation available. It was agreed that the current data collection system would benefit from being more sophisticated.

Therefore a proposal for a more sophisticated questionnaire that covers the points on page 6, was put forward by the Soil Association to the FMG at their committee meeting, with modification, it has been accepted and ran for the first time in February 2003. The first set of data was collected and compiled by the FMG and returned on 28<sup>th</sup> February 2003. The last section of the data that asked milk groups to estimate volumes being utilised as butter, yoghurt, liquid milk etc was not completed which was not surprising as it was optimistic to expect milk groups to have this data. However the possibility of getting this information has not been ruled out in future. Therefore this project has used data taken from the MDC produced by Taylor Nelson Sofres, much of which is relevant to Wales.

## **3.2 Historical data**

Historical data has been obtained from the following sources:

- Federation of Milk Groups – Organic Service – Summary Sheet - January 2003
- Market Prospects for Organic Milk – MDC
- Organic Food and Farming Report – Soil Association

### **3.3 Certification body data**

SA Cert and OF&G have provided information regarding the number of dairy farms in conversion and fully organic which can be used to estimate potential future supply. Although there are a significant number of other certification bodies that licence farms it is known that OF&G and SA Cert certify 80 % of the industry and therefore safe predictions can be made based on this particularly when considering the Welsh and UK industry.

### **3.4 Processor survey**

A telephone survey was carried out of dairy processors licensed with the Soil Association. Welsh and Borders processors were surveyed as well as 3 major UK processors.

They were asked to comment on the following areas:

- 1) Business overview and products
- 2) Growth in business – specific areas
- 3) Projections over next 3 years
- 4) Problems
- 5) Regional issues and branding
- 6) Recommendations
- 7) The role of SA and OCW



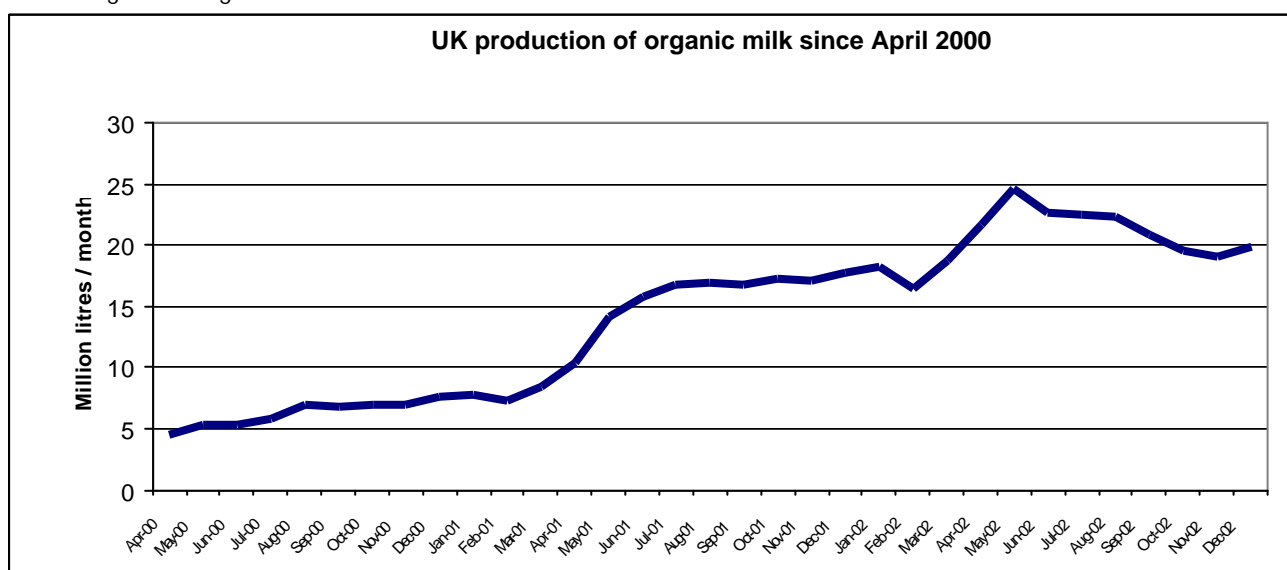
## 4. Results

### 4.1 New FMG data collection system

The current set of FMG data that we have is the first round under the new system and was received on 28<sup>th</sup> of February 2003<sup>1</sup>. It provides a very useful picture of how milk production has progressed over the last few years and gives an accurate and up to date record of the current level and trend in production. It must be borne in mind that this data only represents the milk being handled by the milk groups and does not include milk being sold direct from farm to processor or retailed direct. This is not considered a problem as it gives a clear picture of the state of the open market. The MDC report estimates that 15%+ of organic milk is sold direct and not through milk groups. This milk will all be sold as organic and so puts a significant positive slant on what is otherwise a bigger percentage surplus.

The first summary of the new system was received on 28<sup>th</sup> February. This will enable us to get a more accurate regional picture of production, a clear figure on the milk that is actually being sold into the organic sector and therefore an up to date figure for the surplus. Information regarding volume of milk sold into the organic sector and therefore surplus will also be collected, however is not available at this point.

Figure 2: Organic milk and collections - UK



Source: Federation of Milk Groups : Organic Data Service 28<sup>th</sup> Feb 2003

<sup>1</sup> It must be stressed at this stage that the relationship between the Soil Association and the FMG is a new one and it is vital to its development that we respect the sensitive nature of the data if we are to continue to have access to it. Therefore it is vital that OCW and the Soil Association communicate closely with the FMG before releasing or publishing data since if presented / published without care, it is felt the data could be misused and cause problems for the organic dairy sector.

## 4.2 Production statistics

From FMG data (figure 2) we can see that currently just less than 20 million litres of organic milk are handled by the milk groups each month. This is a drop of 25% in production from the peak in May 2002. However current actual production figures hide a significant volume of potential supply by farmers who have extended their conversion period or stopped feeding the herd organically under non-compliance. It is likely that without improvements in milk price a significant number of producers will cease organic certification when their OFS contract comes to an end, and therefore potential and actual production of milk will drop until price improves. The milk groups are currently surveying their producers on this issue and results will be available in due course.

### Organic land

The area of organically managed land in Wales has risen dramatically between 1998-1999 and 2001-2002, increasing by more than 10-fold from 5,331ha to 58,100ha. There are three main reasons for this considerable increase. Firstly, the organic market between 1997 and 2000 was particularly buoyant, with organic farmers able to secure markets and good returns for most organic products. Secondly, levels of Government support for conversion to organic production increased providing a heightened financial incentive. Finally, poor prices and market insecurity within the non-organic market added a further pull factor for farmers considering conversion.

Figure 3: Historic development of organically managed land in Wales, 1998-1999 to 2001-2002.

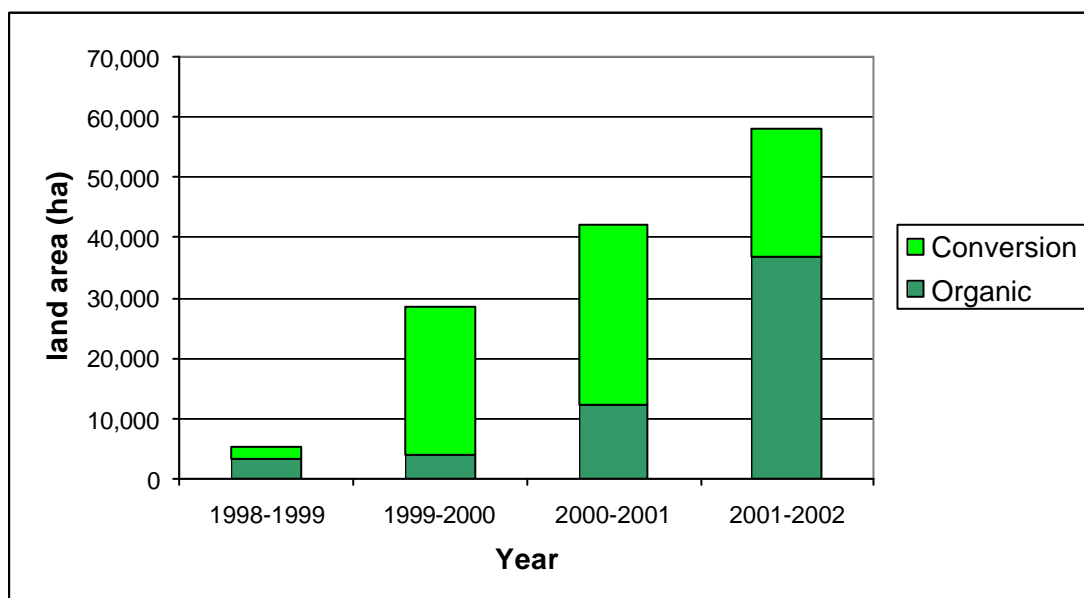


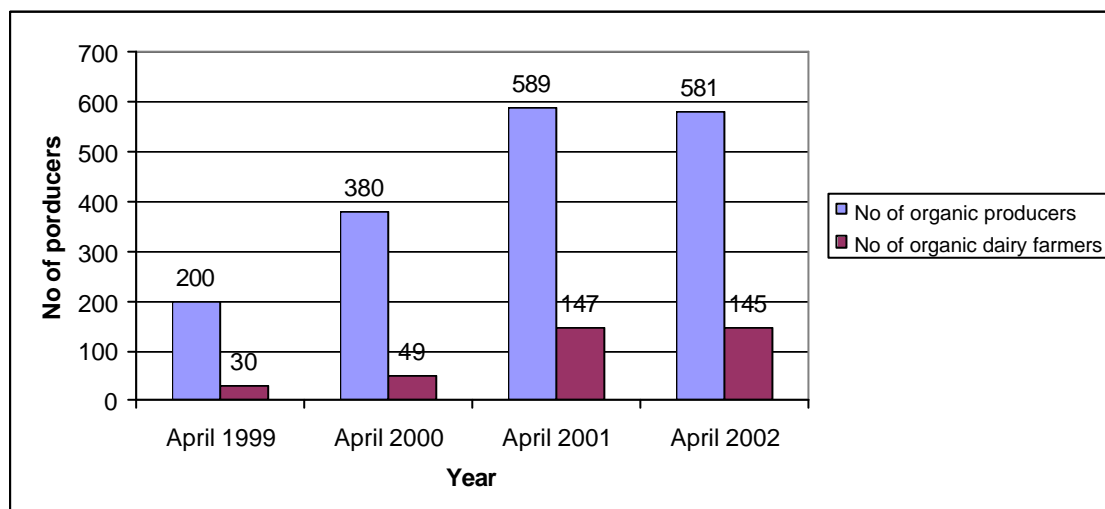
Table 2: Historic development of organically managed land in Wales, 1998-1999 to 2001-2002.

Year	Ha Land		
	Organic	Conversion	Total
1998-1999	3,182	2,149	5,331
1999-2000	4,000	24,495	28,495
2000-2001	12,354	29,676	42,030
2001-2002	37,000	21,100	58,100

### Number of organic dairy farms

Between April 1999 and April 2002 the number of organic producers in Wales increased from 200 to 581. Over the same time period the number of organic dairy farmers increased from 30 to 145 (figure 4). 25 per cent of all organic farms in Wales had dairy enterprises in April 2002. This compares to a proportion of 24 per cent for all organic farms across the UK (Soil Association Organic Food and Farming report, MDC, Future Prospects for Organic Milk). Organic dairy farms account for 3.4% of all dairy farms in Wales. This compares to 2.9% for the UK as a whole.

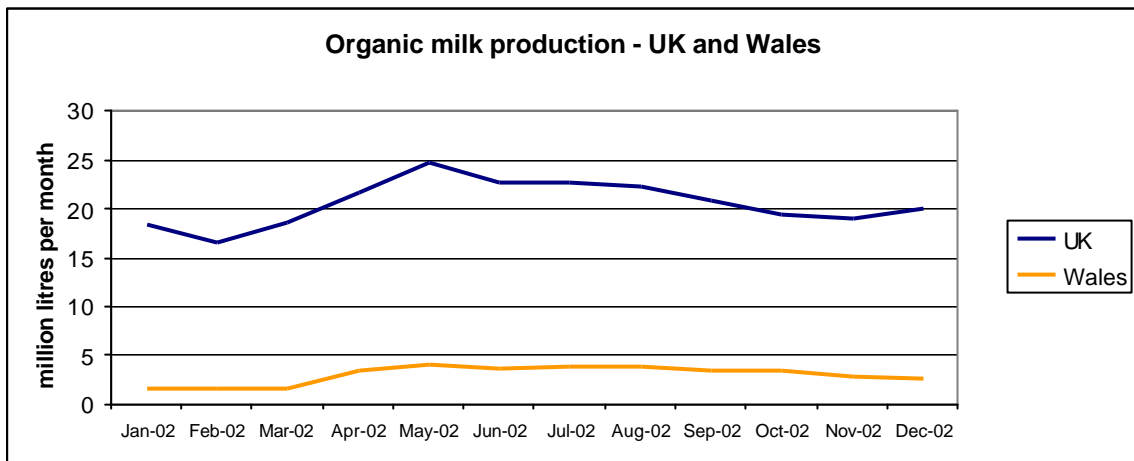
Figure 4: Number of organic producers and number of organic dairy farms in Wales April 1999 to April 2002



## Organic milk production in Wales

According to the Milk Development Council (MDC) report 'Prospects for Organic Milk' organic milk production in Wales was negligible until 2000-2001. Indeed this is the year that saw a considerable increase in organic dairy farmers from 49 to 147 (Figure 4). However, the MDC data is collected from questionnaire returns from organic milk groups. It is likely that prior to April 2001 the collections of organic milk from Wales were relatively small and as such not recorded (Figure 5).

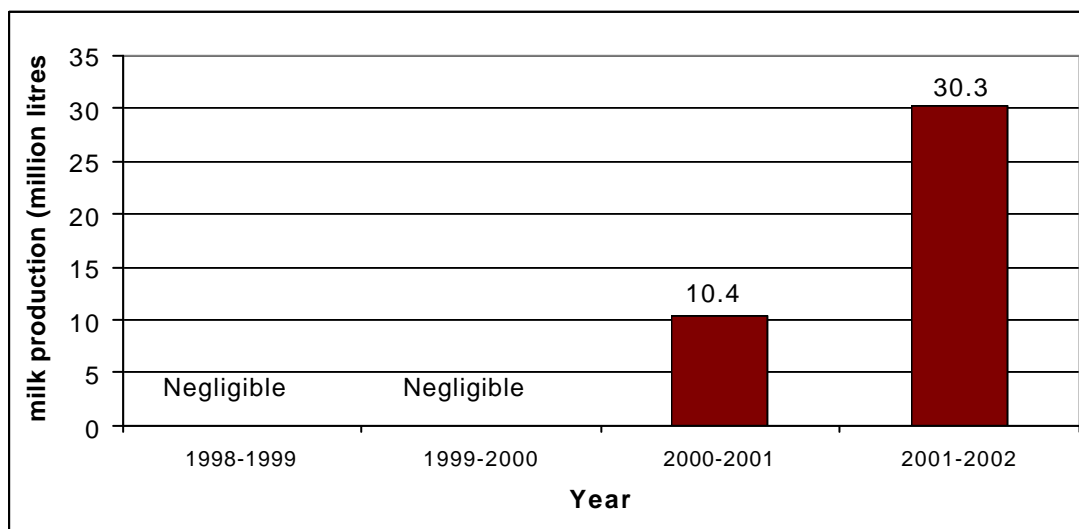
Figure 5: Organic milk production in 2002 – UK and Wales



Source: FMG data service

The MDC report estimated milk production in Wales to be at 30.3 million litres / year during the year 2001/2002 (figure 6). This is backed up by information now available through the new FMG system which tells us that 33.8 million litres (slightly more) was produced in Wales during that year.

Figure 6: Organic Milk Production in Wales, 1998-1999 to 2001-2002



Source : MDC Report, 'Prospects for Organic Milk'.

As a proportion of milk production in the UK Wales accounts for 14 per cent of the total 218 million litres produced.

Table 3: Organic milk production by country, 1999-2000 to 2001-2002

Year	(Million Litres)				
	England	Wales	Scotland	N Ireland	Total
1998-1999	28				28
1999-2000	41				41
2000-2001	66.5	10.4	1.0	0.1	78
2001-2002	181	30.3	4.2	2.5	218

Source: MDC report 'Prospects for organic milk'

### **Organic milk surplus**

Rapid market growth and a sudden surge in capacity to produce organic milk has recently lead to imbalances in supply and demand. This was first noted in 2001-2002 as many dairy farmers completed conversion and were first able to produce organic milk. As a consequence supply outstripped demand. By 2000-2001 a small amount of organic milk was being sold on to the non-organic market. This increased to 81 million litres, or 37 per cent of production, by 2001-2002 (MDC, 'Prospects for Organic Milk').

If it is assumed that the same proportion of milk produced in Wales did not find an organic market as that produced in the whole of the UK then 37 per cent of Wales' 30.3 million litres of production would have gone on to the non-organic market in 2001/2002. This equates to 11.3 million litres.

More recently monthly UK FMG milk group data shows us that the UK production of organic milk has been dropping since May 2002 where it was at a high of 24.6 million litres / month. By December had dropped to just below 20 million litres where it appears to be settling. From the FMG we know that milk production peaked at the same time in Wales at 4.01 million litres / month and is now back at about 3.2 million litres. Therefore the overall surplus must have reduced considerably during this period, and once the ratified data is back it will be possible to quantify this. We might expect this trend to reverse somewhat in spring as some producers increase cheaper production off grass, and therefore production may rise again.

### **Future projections for organic milk production in Wales**

From the FMG data we know that 35.8 million litres of Welsh organic milk was handled by the milk groups in the 2002 calendar year. This is an increase on the "milk year" (April 2001 –Mar 2002) in which 33.8 million litres was handled, which slightly more than the 30.3 million litres estimated by the MDC, particularly when we add 15% for milk traded outside the milk groups.

From certification body data (figure 7) we know that the proportion of farms in conversion and organic farms with non-organic herds is roughly the same as the UK (27%). So we can assume that the potential supply available to milk groups by this summer from Wales is 46.5 million litres per annum.

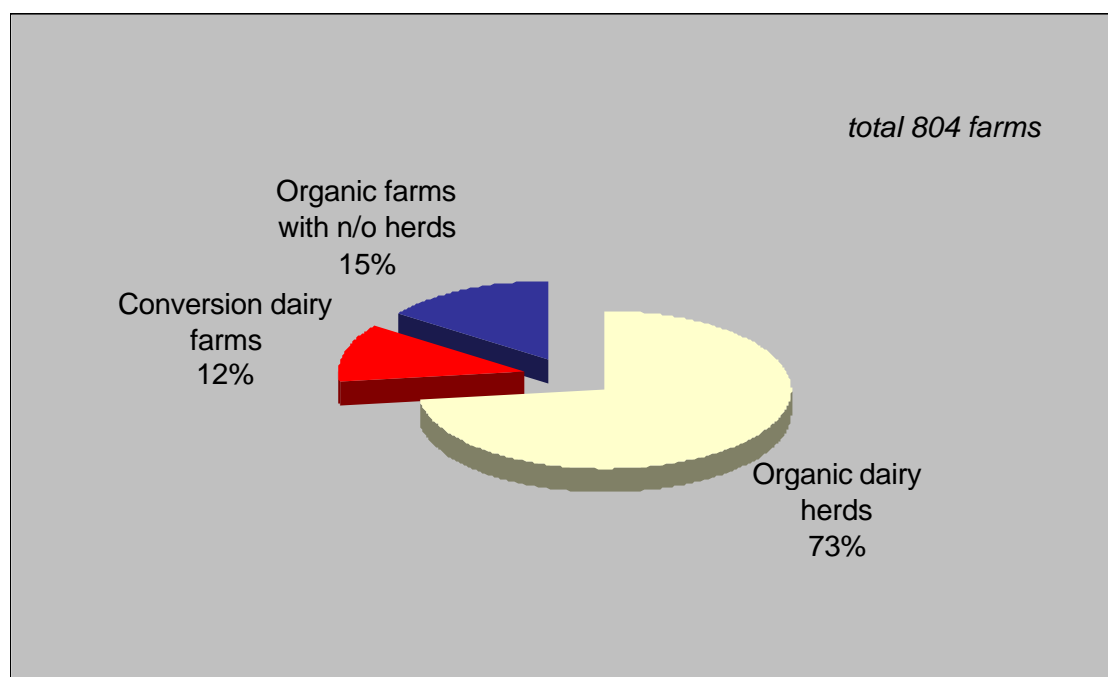
Significant market growth would be required to ensure that all Welsh organic milk produced is sold on to the organic market. It is likely that the majority of milk produced in Wales will continue to be used in dairy products sold outside the region. The potential for regional/national branding should be explored capitalising on Wales' existing reputation for high quality livestock products.

Very significantly this project has identified from the FMG data we have received so far that UK organic milk production peaked in May 2002 at 24.6 million litres /month. As previously stated, since then it has been dropping month on month to the extent that 6 months later it had dropped by 24% to 18.7 million litres per month in November 2002. If it were to continue to decrease at this rate we would expect the surplus of organic milk to be eliminated during 2003. However it is likely that this decline will level or start to increase this spring as the minimising of production bottoms out and with the spring upturn in production.

Regrettably under the current circumstances even when supply and demand converge, this does not mean that all farmers will be able to find a contract or an increase in their milk price. It is not this straightforward since the current decline in production is due to a number of important factors:

1. Regrettably a few farmers who have reached the end of OFS contracts or were never in them have dropped out of organic registration (this number is considered relatively insignificant).
2. More significantly in terms of numbers and volume for the future predictions, other farmers have stayed in the scheme but under "non-compliance" with the regulations; having ceased feeding their cows organically to cut costs and therefore have ceased the production of organic milk. This group is important as depending on the market they will either re-convert their herd when the milk price improves or drop out altogether when their OFS contracts have completed. This situation gives some flexibility for regaining stability within the market, but is legally unsustainable within the regulations and causes problems for both farmers and certifiers.
3. Many farmers who addressed the situation whilst still in conversion have extended their conversion period, and can do for up to five years before they must fully convert the herd and land. This is more sustainable since they do not have to be non-compliant with the regulations and can simply feed GM free non-organic feed with no problem.
4. Furthermore farmers who have continued to produce organic milk are generally under-producing to save costs, and could quickly increase production by roughly 15%

Figure 7: Status of licensed dairy farms (February 2003)



Source : SA Cert & OF&G data, February 2003

The last 3 points must be recognised and accounted for when considering the current drop in organic milk production, since they disguise a significant potential supply, and provide a significant buffer (and delay in farm-gate price increase) as supply and demand come in line. Relatively few farmers have so far stopped dairying or gone out of organic certification (largely because of their OFS contracts) so at the moment we would estimate that the potential supply is still somewhere around the 25 + million litres / month mark. This correlates with figure 7, which shows that of the total licensed dairy farms only  $\frac{3}{4}$  of them are currently producing organic milk. Most of the remainder are either non-compliant or have extended their conversion period so in effect could produce organic milk within 3 months. Since few dairy farms embarked on conversion after the summer of 2001, we can assume that by this summer all of the remainder would be able to produce organic milk if the price allowed, if they cannot already.

### **Future considerations affecting production**

Most dairy farmers converted in 1999 and 2000 so they will be obliged to stay organically registered until 2004 / 2005. At this point unless farmers can obtain a milk price or financial incentive from government grants that will sustain their business including the cost of organic feed then it is likely that large numbers of farmers will drop out of organic certification or dairying. This will mean that the oversupply and "reserve supply" can start to reduce quickly at this point, however it is clearly negative in

terms of the wasted investment made by farmers and government in organic conversion and would be a regrettable resolution to the current problems. There is also concern that the market could switch back to a situation of under-supply in a short space of time if the situation is not managed carefully during 2004, thus perpetuating the crisis and returning to a reliance on imports. With no dairy farms currently entering conversion it would take at least two years to rectify.

When considering these issues it must also be considered that the UKROFS / EU feed conversion requirements for dairy cows will be increased from 3 months to 6 months on the 31st August 2003, increasing the time and cost of converting herds after this date.

In addition the non-organic allowance is set to be removed in 2005 which, it is estimated, will increase the price of feed by £55 / tonne. This equates to £82.5 / cow or 1.4p per litre on the cost of production. (Mike Thompson – BOCM Pauls). It is likely that this will encourage farms to produce milk from forage, and less reliance on concentrates. This is desirable from an organic perspective and there is evidence from OCW's monitoring work that this is happening and will continue. However this may trigger more spring calving herds and seasonal UK organic milk supply, with the danger of imported milk taking up the winter slack. This is something both farmers and milk groups should be planning for.

### **4.3 Processor survey results**

#### **Growth**

The mood amongst organic dairy processors is generally positive although the atmosphere growing more competitive. With the exception of two cheese-makers whose organic business was static, most companies were still reporting growth in business between 10 and 50% per annum, with a couple predicting up to 100% increases annually (mostly small or new businesses). This correlates with FMG data which shows that the volume of organic milk sold into the organic market by the milk groups is currently increasing by 20% per year. Of those that were growing, although in some instances the rate of growth was slowing, none predicted a levelling off in the next 3 years. It was apparent that new businesses or small to medium sized companies that are actively seeking out new business were seeing the greatest growth rates, individual or smaller contracts being able to have a considerable effect on their proportional growth. Larger companies were still making projections of growth at around 10 – 15% but were clear that they would not grow at this rate without actively seeking out new contracts and promoting their business. This is a very different situation from 3 years ago when organic products "sold themselves".

#### **Particular areas of growth**

Although growth was reported within current product ranges and contracts, it is clear that the opportunities for maximising business growth were through seeking out new markets, products and contracts. This indicates that there are still a good number of market niches to be filled for processors



willing and able to identify and act on them. Encouragingly for small businesses, smaller contracts to supply regional supermarkets with regional milk and dairy products were being secured, as well as supplying national retailers with specialist products.

### **Problems**

Larger processors identified a major problem when dealing with supermarkets, in that they will not accept price rises on product lines, regardless of inflation or increasing costs of production. Increasing potential for cheaper imports from Eastern Europe does not help as this undermines baseline prices. This position is unsustainable in the medium to long term and if left without intervention, will ultimately result in a collapse of the UK organic dairy industry and therefore retailers not being able to supply British organic milk to customers that expect it.

There are still major problems reported of supermarkets having organic milk shelves lying empty on a regular basis and this is identified consistently by consumers. It is possible that staff prioritise to keep primary items stocked which means that organic products are often left until last, increasing the frequency of empty shelves. This issue is thought to be significant to sales not representing actual demand and is a problem for the organic sector.

Smaller processors and new / local businesses were finding the haulage and distribution of goods to be a major problem, as well as finding the time to employ the extra staff as a businesses move from being family / self employed to employers of further staff. However new businesses can take advantage of WDA part funding of salaries to help with the cost of salaries for new staff under the WDA farm diversification scheme.

Some processors were having trouble with technical issues as they developed new lines and refined their processing, for example with processing quality of milk and fat / protein levels. It is worth pointing out that Welsh processing companies can take advantage of the services offered by the Food Centre Wales which is a WDA funded research and development subsidised service available to help Welsh food processors with technical problems.

One processor complained that the Soil Association had been too slow to communicate to them changes in processing standards that would have a significant effect on their business that were being discussed at UKROFS and EU level. They needed to be informed at the earliest stage about such discussions.

### **Branding**

All processors considered branding critical to securing contracts and customers, however the branding used had to be appropriate to the customer.

Proper branding is considered essential to maintain a positive and strong identity for organic food. The value of strong independent organic brands rather than retailer "own-label" products are essential to ensure organic farming is promoted in the best way for the industry, and gives organic businesses direct and powerful access to their end customers. In the organic food sector brands that identify with people or places have been particularly successful.

The importance of an organic label was vital in most contracts and important for customers, however it is felt that the potential to develop the strength of the organic message and buying habits is still under-developed. There is considerable potential to improve the image and profile of organic farming through education and promotion. It was felt that this promotion and education needs to be pushed by organisations such as the Soil Association and OCW, at the same time it is vital that all farmers and processors continue to emphasise the reasons and importance of buying organic to enforce this message at every level. It is particularly important to do this on branded products making their way into supermarkets as an opportunity to have control over how the information is given to the wider public.

It is also important to guard against a potentially negative association with the organic label. Farmers and processors have to do this by aiming to provide only high quality products that deserve a premium for their look and taste, as well as the other benefits that are behind organic food, since an initial negative experience can stop repeat buying.

It was also pointed out that in some quarters organic farming has a poor image and the organic label has hindered sale of products. It was suggested that this may be the case in rural areas where conventional farmers and farming communities may feel be affronted by criticism or the implication of criticism by the organic movement. It is important that organic farmers and organisations aim to encourage conventional farmers and rural communities to see the benefits off organic methods through positive means as much as possible. There are other common criticisms that also may prevent buying; doubts about the integrity of the certification system and criticism of organic food's current international origin that all make good anti-campaigns by those who do not approve. The importance of promoting local at the same time as organic as well as a strictly enforced certification scheme can not be understated in response to this.

The Welsh and local origin is an important factor not only for customers in Wales, but also strategically used for products being sold throughout the UK, capitalising on a sense of extensive and traditional farming and high quality products associated with Wales. Most processors felt that the regional aspect can be a major help for business, or a hindrance in some circumstances of "regional export", and should be used carefully and strategically. It is still felt that there is a lot of potential to market products based on their origin and that opportunities were being missed to replace products, possibly imported, without an origin stated. This applies throughout the whole UK and is simplest message that consumers

generally always favour on non-exotic products. This will be vital in fending off pressure on price and market share from Eastern European imports.

### **Role of OCW and partners**

In addition to their current activities, the processors believed that bodies such as OCW and the Soil Association should concentrate more effort on gathering and presenting information that can be used to promote the positive benefits of organic farming, and keeping it at the forefront of the public agenda. They were generally in favour of avoiding criticism of conventional farming. Although they accepted it was difficult to promote the virtues of one method of farming without by implication objecting to something about another, the importance of not creating animosity is vital to progressing market development. They felt that education and work in schools was encouraging and vital and that maximum effort should be invested in this.

It was suggested that more could be made of the possible physical and therefore health differences between organic milk and conventional milk. One of the cheese-makers (who did organic and non-organic cheeses) pointed out that he and other cheese makers noticed a clear difference in the time taken for his organic cheese to ripen (it was quicker), and said that others in the trade had noticed the same. This he attributed to higher biological activity and lower antibiotic / chemical residues in the product and suggested some work could be done to look at this and promote it if proved. Another processor was interested in work in New Zealand which suggested the higher clover intake of organic herds produced higher levels of Omega 3 fats in the milk, and suggested that this should be investigated.

### **Range / choice**

Both large and small producers felt that customer choice and range was a key factor in developing a customer base, and this worked on two levels. Processors of branded products with a wide range were more likely to have customers try at least one of their products and if impressed were likely to try others in the range. It is also a major help for small retailing businesses if they offer not only their primary product, but also compliment this with others produced either by them or other companies, adding to the convenience of a "one stop shop". It was also noted that other "non-organic" retailers had attracted customers specifically because they offered pre-packed, but locally produced organic food.

### **Milk sales outside of multiple retailers**

One issue identified by processors that could hold significant potential for the organic dairy sector that was identified is more than any other food product, a huge proportion of milk is sold outside of the multiple retailers. As a fresh product commonly purchased daily rather than weekly, it tends not to justify a trip to the supermarket if available more locally. One processor suggested as much as 45% of milk is retailed outside of super-markets yet organic milk rarely seen in local stores. There would appear to be a missed opportunity and a huge potential for increasing sales if effort were put into

supplying organic milk into the local store sector both regionally and nationally. Conscientious or organic consumers may also be those that see the value in patronising local shops in preference to supermarkets in some areas. This point may be particularly significant when trying to increase organic milk sales outside of urban centres.

### **Use of available services**

Particularly in Wales, but also in other areas of the UK there are a large number of services available to farmers and processors that should be capitalised on. Free and subsidised technical information, support, advice and research can be obtained through bodies such as the Organic Centre Wales, Farming Connect Welsh Development Agency, and the Food Centre Wales. As mentioned before the WDA also help part fund employees under the farm diversification scheme as well as help with label costs and business grants. These services have a large potential to benefit farms and processing businesses if fully taken advantage of.

### **4.4 Sales of organic dairy products in Wales**

The market for organic produce across the UK has grown very rapidly since 1998 with sales for the year 2001-2002 reaching £920 million. This equates to growth at an average of approximately 30 per cent annually between 1998-1999 and 2001-2002. Over this time the market for organic food has grown faster than any other category in food and drink sales. Current FMG data shows that the monthly volume traded as organic increased from roughly 11 million litres / month in January 2002 to 13 million / month in December which would indicate that current growth is still approximately 20% per annum.

### **Consumer penetration**

The main driver for growth has been an increase in penetration – the number of households buying organic food. In 1997-1998, 37 per cent of UK households made at least one organic purchase (TNS, Soil Association Organic Food and Farming report 2000). By 2001-2002 this had risen to 79 per cent. Also (like the organic market as whole) sales of organic dairy products are dominated by a core of committed organic consumers, with 3.6 per cent accounting for 69.1 per cent of spend (Figure 8).

Within the organic market as a whole the dairy market has also experienced considerable growth (Table 3). In 2001-2002 the organic dairy market was valued at £95 million accounting for 1.7 per cent of the total dairy market displaying growth over the year of 15 per cent. Like the organic market as a whole this growth can be largely attributed to increased consumer penetration.

Figure 8: Breakdown of organic and non-organic dairy market in Wales by sector, 2001-2002

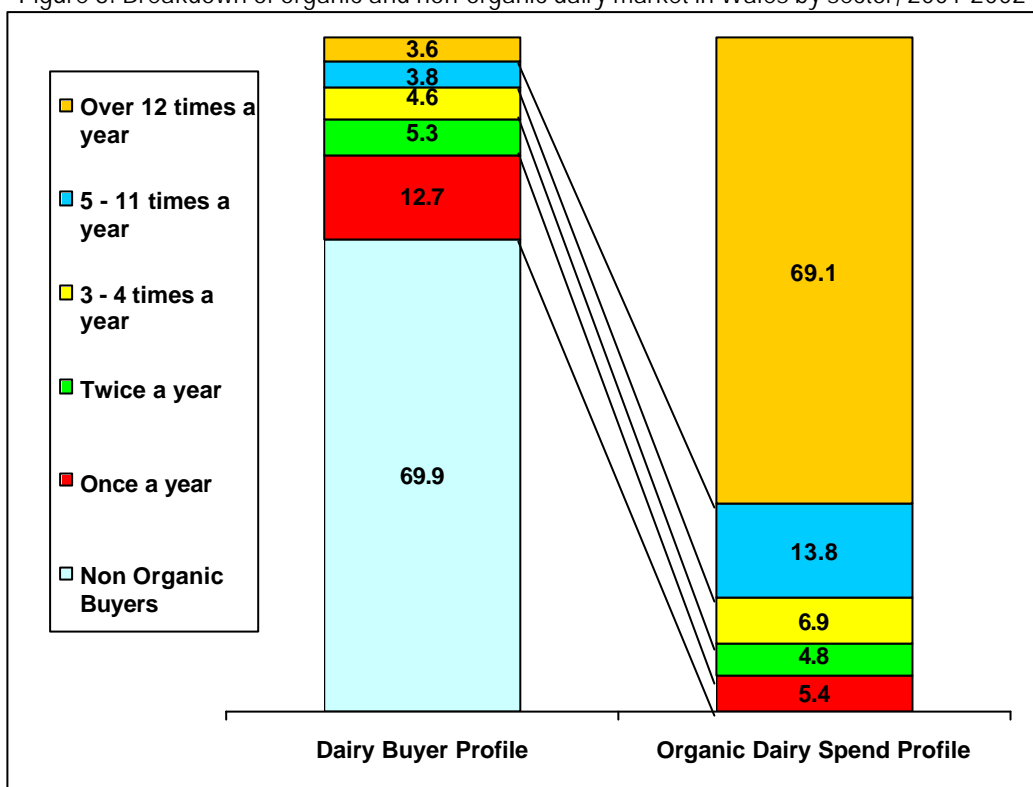


Table 4: Growth in the market for organic dairy products, 1999-2000 to 2001-2002

Year	Value (£million)	Growth April to April (%)
1999-2000	64	
2000-2001	83	30
2001-2002	95	15

Source: TNS Superpanel, MDC report 'Future Prospects for Organic Milk'.

However, between 2000-2001 and 2001-2002 the average expenditure and frequency of purchase per household decreased. This is a worrying trend that reflects a lack of commitment by consumers to making repeat purchases. Clearly repeat purchasing and elevated expenditure are key to the future of organic market growth in all sectors, including dairy. Education and awareness combined with high quality products are recognised as key requirements in developing customer loyalty.

### Organic market in the UK and Wales

The organic dairy market in Wales in 2001-2002 was worth £6.8 million. This represents growth on sales in previous years but worryingly the average expenditure of organic dairy consumers in Wales decreased by 22 per cent, the highest of any region/nation in the UK. Growth has therefore been driven by new, light organic dairy consumers. As a proportion of total dairy sales in Wales organic accounts for only 1.6 per cent (table 5).

Table 5 : Organic dairy market in UK and Wales - value and share, 2001-2002.

- 1 UK total market value (organic and non-organic) (£)
- 2 UK total organic market value (£)
- 3 Market in Wales as a proportion of total UK market (1) in percent
- 4 Organic market in Wales as a proportion of total UK organic market in percent
- 5 Total market value Wales (Organic and non-organic)
- 6 Total organic market value
- 7 Proportion of market in Wales organic

Break down	1 in billion £	2 in million £	3 in percent	4 in percent	5 in million £	6 in million £	7 %
Total Dairy	5.6	95	7.8	7.2	435	6.8	1.6
Liquid Milk	1.6	26	7.5	9.8	120	2.6	2.1
Cheese	1.6	16	7.7	5.7	123	0.9	<1
Yoghurt	768	44	7.6	6.2	58.4	2.7	4.7

Source: Based on data from the MDC report '*Prospects for Organic Milk*'

### **Break down of the market**

By category, yoghurt accounts for the highest proportion of organic dairy sales in Wales at 40 percent, in line with the UK as a whole. This contrasts to the break down of sales for the non-organic dairy sector in the UK in which yoghurt only contributes 13.7 per cent (TNS Superpanel, MDC report '*Prospects for Organic Milk*'). This is due to the existence of established brands of organic yoghurt with a secure and loyal customer base.

Liquid milk consumption in Wales is relatively low per household compared to the UK average with 143 litres purchased per household per year, compared to 162 litres in the south west and 168 litres in Scotland (TNS Superpanel, MDC report '*Prospects for Organic Milk*'). Between 2000-2001 and 2001-2002 sales of organic liquid milk across the UK increased by 13 per cent from 23 to 26 million litres. However, this growth was not emulated in Wales. In contrast sales of organic liquid milk in Wales declined faster than in any other region/nation falling by 28 per cent from £3.6 million to £2.6 million. This is despite an increase in the number of households buying organic milk in Wales. Again this reflect a decrease in frequency of purchase and expenditure per household.

Sales of organic cheese in Wales accounted for 13 per cent of all organic dairy sales during 2001-2002 at £0.9 million, in contrast sales of non-organic cheese in Wales made up 28 per cent of the total dairy market in Wales. This under representation of cheese is thought to be due to availability of processing facilities and a lack of brand development. As a proportion of the UK organic cheese market, Wales accounts for 5.7 per cent, compared to 7.2 per cent for the whole dairy category. The most worrying development in the organic cheese market in Wales has been the decline in frequency of purchases. From April 2001 to April 2002 Wales showed a higher decline than any other region/nation with the

number of purchases per buying household falling by 20 per cent (MDC report '*Prospects for Organic Milk*').

In contrast to milk and cheese, there has been a growth of sales of organic yoghurt in all regions, including Wales. Sales of organic yoghurt in Wales account for 40 per cent of all organic dairy sales, making their contribution financially even greater than liquid milk. The relative contribution of yoghurt contrasts to the non-organic dairy market in Wales where yoghurt sales account for 13 per cent of the total dairy market. However, expenditure per household declined by 8 per cent between April 2001 and April 2002 (MDC report '*Prospects for Organic Milk*'), again indicating problems in achieving loyalty and repeat purchasing.

### **Future market predictions**

Growth in the organic dairy market in Wales has been driven by an increasing number of households making organic dairy purchases. However, growth in sales has been hindered by a decrease in frequency of purchase and expenditure by many households. If this trend continues and penetration reaches saturation then the market for organic dairy products in Wales will decline. It is therefore important that progress in the market is focussed on developing all consumer measures - penetration, frequency of purchase and expenditure. Brand development and consumer awareness will be pivotal in achieving this.

It should be highlighted that the size of the organic dairy market in Wales is still very small (only 1.6% of non-organic). Small changes in consumer purchasing behaviour will have significant impacts on the market. Market analysts predict a period of consolidation followed by more steady growth. This will hopefully allow for equilibrium to develop between supply of organic milk and demand for organic dairy products. Cheese looks to be an area for potential growth if the market evolves to display a similar breakdown to the non-organic market (table 5).

## **5. Conclusions**

### **Balancing supply and demand**

1. If the volume of organic milk collected by milk groups continues to decline as it has over the last 6 months than the surplus will be eliminated much sooner than expected (although there will be a significant potential supply from licensed farms not currently be producing organically). It is felt more likely that the production of organic milk levels roughly where it is now (around 20m litres / month) during 2003, and at the current increasing rate of utilisation (20%/annum) it would then take between 2 and 3 years for demand to converge with supply. The estimated current potential supply (including non-compliant and extended conversion producers) is at least 25 million litres month; therefore it might be at least 4/5 years before demand reaches this level (2007/2008).
2. Against this the greatest number of organic dairy farmers entered conversion between 1999 and 2000. These producers' OFS contracts will expire in 2004 & 2005. At this point if there is not the financial incentive to remain within the organic system a significant proportion of these producers are likely to deregister their land, may revert to conventional farming methods partly or completely, or may give up farming. Therefore during 2004 it is possible that large numbers of dairy producers start to drop out of organic production if it is not viable for them (roughly half the total organic dairy farmers would be in a position to drop out by the end of 2004).
3. There is concern amongst milk groups that if significant numbers drop out during 2004 this could throw the organic sector quickly back into a position of under-supply and reliance again on imported milk. With no farms currently in conversion it would be a further two years before this could be rectified.

### **Price and Market Development**

4. Currently it is felt that the viability of organic dairy farms becomes questionable when milk price falls below 24p /litre. The removal of the non-organic stock-feed allowance is set in 2005, which would add up to 2.5p extra on to the cost of producing organic milk that would also have to be incorporated.
5. There is significant scope to increase the current rate of growth in organic milk consumption through education, responsible campaigns and promotion, retailers ensuring organic milk is available, and through the significantly under exploited local store sector.
6. The organic sector with interested parties need to form a strategy to cushion those farms that have converted yet have no access to a premium market. Sector bodies have aimed to do this by taking minimal sanctions against farmers unable to feed stock organically. This situation needs to be secured so that it does not cause problems for organic farmers.



7. There is a need for improved data collection and market information in the organic dairy sector. This project has made significant developments in this area but the system needs to be developed and built upon.
  
8. Branded products offer the potential to develop the market but are difficult to place in some retailers. In addition placement of organic milk on retailer shelves is still an issue that needs to be resolved.

## 6. Recommendations

1. The formulation of an action plan for the organic dairy sector. A meeting should be held as soon as possible between organic dairy sector representatives, certification bodies, UKROFS, NAW, DEFRA and the appropriate assembly and government ministers. The aim being to discuss problems being experienced in the organic dairy sector and to formulate the best strategy to move forward and deliver government objectives whilst aiming to avoid penalising farmers that have chosen to convert to organic production.
2. Producers, processors, retailers and organisations such as OCW and the Soil Association focus their efforts on increasing sales of organic milk through strategies such as those high-lighted in this report. These should include developing consumer awareness and improving product availability. Measures include identifying clear benefits (including exploration of health benefits) of organic dairy products which are then delivered clearly to the consumer. More work to ensuring that products are more widely available in retail shops, more penetration of the local store sector and ensuring that supermarket shelves are stocked through development and training store staff. Identification of new outlets such as garages and schools. Promotion of milk and dairy products on other organic products and shelves such as vegetables and meat.
3. Certification bodies and UKROFS should work to ensure that farmers obligated to stay in their OFS contracts are not forced to feed cows organically before either it is viable to do so or they have the option of de-certifying with no penalty.
4. To prevent large numbers of farmers dropping out and switching the market to under-supply, producers need to have a sustainable milk price or the promise (contract) of one before this happens (i.e. by the beginning of 2004). This is up to the milk buyers but certification bodies should be able to help by ensuring that producers have discussed all options with milk buyers decertifying farms, and closely monitoring licence terminations.
5. Ongoing agri-environment payments need to be high enough to encourage producers to retain organic status, given the environmental benefits it is now accepted that organic farming delivers. The National Assembly for Wales need to ensure that their money is used to effectively deliver the stated aims of agri-environment policies and organic action plans, and that the positive progression already paid for by the OFS is not wasted by farms reverting to conventional farming methods.
6. That the Soil Association on behalf on of OCW and other organisations continues to work closely with the Federation of Milk Groups on data collection and developing systems, whilst respecting the commercial sensitivity of information and disseminating the relevant information effectively. The Institute of Rural Studies should be included in this work to collaborate with the work they carry out

on benchmarking, dairy farm incomes and statistics. The potential to link into the MDC milk price datum service and develop this for organic dairy production has been identified, and should be investigated.

7. That future projects aim to develop intelligence from national retailers to help develop a system of data collection on consumer buying trends / product placement and branding.

## 7. References

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## 8. Glossary of terms

- **DEFRA:** Department of Environment, Farming and Rural Affairs – Government ministry that replaced MAFF in England
- **FMG:** Federation of Milk Groups – part of the NFU that confidentially collects and reports the cumulative data from milk groups and co-ops
- **Feeding under non-compliance:** Once a farm is fully organic, EU and UKROFS regulations require that animals kept on the holding for more than 120 days / year must be managed to full organic standards including feed. Currently due to poor organic milk price and high organic feed cost many farmers have been unable to do this and are hence "non-compliant". They are therefore not selling the milk as organic.
- **MDC:** Milk Development Council – "Market Prospects for Organic Milk" (2002)
- **OCW:** The Organic Centre Wales
- **OF&G:** Organic Farmers and Growers
- **OFS:** Organic Farming Scheme – A five year payment scheme offered by DEFRA and the National Assembly for Wales for farmer who undertake organic conversion. The scheme ties producers in to remain registered to organic standards for 5 years.
- **SA Cert:** Soil Association Certification Ltd – the certification business set up and owned by the Soil Association charity which certifies to SA standards.
- **UKROFS:** United Kingdom Register of Organic Food Standards – the DEFRA department that is responsible for the implementation of the EU organic standards in the UK and overseas the certification bodies such as the SA Cert.
- **WDA:** Welsh Development Agency