

A SUSTAINABLE DAIRY INDUSTRY

IN JERSEY

FINAL REPORT



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Draft Final Report Prepared for the States of Jersey

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I. INTRODUCTION

I.1 Background

Promar International¹ was asked by the States of Jersey to carry out a review of the dairy sector on the Island. This report sets out our detailed findings on the current situation in the Jersey dairy sector. The Terms of Reference (TOR) for the assignment were as follows:

- to critically assess the Jersey MMS as operated by the JMMB and its processing, distribution and marketing arm, Jersey Milk
- to assess the dairy industry recovery plan, which involves the relocation of the dairy processing plant to the proposed site at Howard Davis Farm (HDF), improving the farm efficiency and improving the genetic status of the Jersey Island breed
- to evaluate the optimum level of milk production in Jersey in light of current liquid milk consumption on the Island and the effects that this level will have on the marketing strategy of Jersey Milk, the price paid for liquid milk by customers and consumers in Jersey and the returns paid to milk producers
- to assess the comparative situation in Guernsey and draw any valid comparisons
- to identify mechanisms to allow for a change in the optimum level of production, which leads to an orderly shift in production as needed, which maintains the production above the liquid milk market and which creates value that can be realised by those that would wish to leave the sector
- to identify, compare and then consider the advantages and disadvantages of differing milk marketing structures for the dairy sector in Jersey in order to comply with the current competition legislation
- to consider the impact of the States controls on the import of liquid milk on the future development of the Jersey dairy sector

¹ Promar International is a specialist agricultural and food consulting company and has a particularly strong level of expertise in the UK and international dairy sector

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- to identify the most appropriate future structure of the dairy industry in Jersey (based on the various potential models already identified) in order to provide value for money for consumers and provide an adequate return for the efficient milk producer and cost effective States aid payment

Promar made an initial visit to Jersey in late July 2006 and work was formally commenced in the second week of August. A series of meetings and consultations have been held with a wide range of interested industry stakeholders on the Island in the subsequent period, mainly between August and September 2006. This included meetings with individual farmers across the Island and a summary of the findings from this research is given as Appendix I. Between October and November a series of additional meetings have been held on the Island to discuss the draft findings and conclusions of our report. This document now serves as the Final Report.

1.2 Acronyms

The following are commonly used throughout the report:

AMPE	Actual Milk Price Equivalent
FBA	Farm Business Accounts (produced annually by Promar International)
DICS	Dairy Industry Costings System of Jersey
FCB	Farmer Controlled Business
HDF	Howard Davis Farm
IMPE	Intervention Milk Price Equivalent
JCRA	Jersey Competition Regulatory Authority
JD	Jersey Dairy
JMMB	Jersey Milk Marketing Board
MDC	Milk Development Council
MMS	Milk Marketing Scheme
MOPF	Margin Over Purchased Feed
PIN	Profit Index
PPE	Public Policy Exemption
ppl	pence per litre
SMP	Skim Milk Powder
USP	Unique Selling Point

1.3 Acknowledgements

We would like to thank the following in particular for their help and support throughout the course of the study:

- Dr P Le Miere - Director, Environmental Management and Rural Economy, Economic Development and Planning and Environment
 - Mr J Jackson – Environment Division, Planning and Environment Department
 - Mr K Keen - Jersey Dairy
 - Mr A Le Gallais - Jersey Milk Marketing Board
 - Dr D McQueen - Consultant
- as well as all the other respondents and key industry stakeholders we met on the various visits made to Jersey in the course of the assignment. This is much appreciated.

2. EXECUTIVE SUMMARY

How It Has Been

1. The Jersey Milk Marketing Board (JMMB) was first set up in 1955. Clearly since that time, much has changed both on and off the Island. Marketing boards, such as the JMMB, originally operated on a world wide basis – not just in the dairy sector – but in many other areas too – meat, fruits and vegetables and the cereals sector to name a few. Accepted as “the way to do it” 40 years ago, around the world over the last 10 – 15 years, the role of monopoly marketing boards has increasingly been seen as “not the way to do it (anymore)”.

How It Is Now

2. The Jersey dairy sector has existed for the last 30 years against a background of highly competitive international food markets, deregulated markets and less protection for primary producers and a reduction – or in some cases a total removal of the monopoly powers marketing boards, existed. The Jersey dairy sector has been operating in isolation of the UK and other EU markets for most of this time. However, it is recognised that the current management of the JMMB and JD has made a number of improvements to the business in difficult circumstances over the last 3 of these in particular.

The Future

3. There are a whole plethora of challenges to the future of the dairy sector on Jersey that have to be faced up to in the next few years ahead – and in some cases the timespan is much shorter. The external challenges of what happens if liquid milk imports come on to the Island and the critical need to build exports to the UK are fundamental to the future development of the Jersey sector. Other challenges include the following:
 - a ruling likely on the status of the JMMB as a monopoly buyer and seller of milk on the Island in light of challenges to this position from an individual farmer
 - there is need for better genetics to survive – even if it takes up to 10 years to see the full benefit of this and the ban on imports on to the Island is challenged
 - the States of Jersey wants to preserve “*brown cows in green fields*” with a sustainable dairy sector that move forward in the future

There are too many challenges to the Jersey dairy sector, with the implications being too significant in terms of impact, to carry on along the somewhat isolationist route of the

past for too much longer. This is despite some of the more positive changes made by the JMMB and the JD in the last 3 years.

4. UK mainland co-operatives and plc's alike in the dairy sector are very aggressive in the purchase of milk, price setting and encouraging supply when they want it and perhaps even more importantly - *when they do not want it* – not least they are very strong on secondary balancing and processing. Across a full range of criteria, all of the JMMB market price signals (compared to mainland UK processors) to producers are weak, if not actually misleading.

Industry Recovery Plan

5. The strategy is, on paper, relatively straightforward. As is often the case the theory of the strategy is relatively straightforward and to our mind makes a good deal of sense but the actual implementation of it is proving more difficult.

Factory Location

6. The current dairy is 40 years old. It needs substantial investment in order to replace some of the very inefficient manufacturing equipment. The dairy as it is currently, will not easily pass the sort of quality assurance inspection that the higher value market buyers (e.g. Waitrose, Marks and Spencer) would expect from their suppliers.
7. The indicative value of the site could be around £9 million, and so the first aspect of strategy would work. With planning consent, the JMMB net assets would be in the region of £6.5 million, after the pension deficit and redundancy costs are paid. The idea that the sale of the Five Oaks Site solves all of the problems of the JMMB and the JD seems somewhat fanciful.
8. Ongoing delays in the search and identification of a new site for the JD will prove to be damaging. HDF is the best available site and the go ahead should be given to move to here as soon as possible.
9. The overall costs between leasing and buying are probably over a period of time not that much different. Leasing might be the less risky to the JD in the short term, but buying outright might give more stability in the mid to long term. It also reduces the chance of a small number of farmers making a move for what might be seen as a “cash pile” resulting from the sale of the Five Oaks site.

Genetics

10. The use of imported genetics to guard against inbreeding within the Island population or to improve specific traits has been considered on several occasions, the most recent of which was in 2003. This followed the production of a very thorough report into this issue by Dr Maurice Bichard, entitled "*Sustainable Development of the Island's Dairy Cattle*". This report clearly recommended that imported genetics should be used. It would take approximately seven years for any additional initial investment in imported genetics to become cash positive for a typical 120 herd farm on the Island.

Jersey Dairy Product Mix

11. In terms of product mix supplied from the JD, the strategy is to supply Jersey with Jersey produced local milk, currently c. 9 million litres pa. The objective of reducing their wholesale price of milk, so that it could be retailed at around 70 – 72 ppl is entirely correct. It is also important to recognise that to maintain a given volume of wholesale milk supply to customers 365 days per year, there has to be a structural surplus of milk. This suggests a minimum ex-farm production of 11.5 – 12 million litres per annum to satisfy the Jersey liquid and fresh product market. SMP and butter are world traded low price commodity products.
12. Jersey will never compete with the worlds' lowest cost, but high volume milk producers in New Zealand, Australia or Latin America. The strategy is therefore correct, to move away from commodity product that cannot compete with the UK on price, let alone the rest of the world.
13. However, it also that means that the JD must find a higher value market for these structural surplus products, in what is an aggressive international market place. The plan for the new dairy is for 14.5million litre capacity, which infers the need for a substantial market for products from 5 million litres of milk. These have yet to be secured. And it might take a further 12 – 24 months before any tangible success is really achieved.

Financial and Technical Performance

14. A comparison of the financial performance of the Jersey dairy herd vis a vis the mainland UK clearly shows the strengths and weaknesses of the average Jersey dairy farm. Total direct production costs are 11.9 ppl greater for Jersey dairy farms, when expressed per litre of milk produced. The relevance of this large difference in milk production costs is that if Jersey retailers choose to import milk at some future date, and if they are able to in law, then it is from the UK that milk is likely to be sourced. There is a bigger range between the performance of the top 25% dairy farmers and the average in Jersey than on the UK mainland, suggesting that improvements can still be made by many.

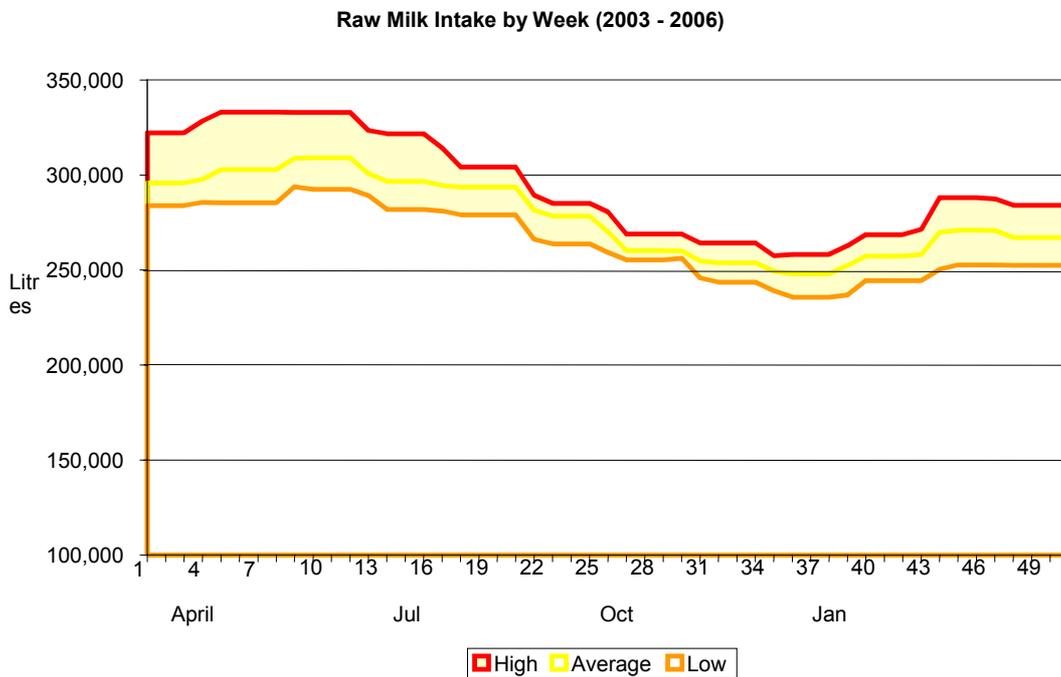
Liquid Milk Imports

15. The import of liquid milk onto the Island is a highly emotive issue on Jersey and has been for some time – and as such it needs to be handled with a degree of sensitivity. There are both plus and minus points regarding the situation which impact on the future structure of the industry and the desire that government has to see “brown cows in green fields”. If milk was to be imported, the farming sector would be put under severe pressure. The industry would go into free fall - in its current state. Government objectives of “brown cows in green fields” would be thrown into turmoil.

Supply of Milk

16. Figure A shows the natural variation in milk production in Jersey over the last 4 years. Although these peak to trough ratios are relatively low, they still mean that at times of peak production (between May and June in particular) the Jersey dairy industry would be producing upto 35% more milk than was required. This situation is not unique to Jersey, and is a situation faced by dairy companies all over the world.

Figure A - Jersey Dairy Raw Milk Supply



17. To minimise this cost, most dairy companies use a range of tools and incentives to try and minimise production of “buffer milk” by better matching their milk intake curves with the milk demand curves. In the past, the main method for dairy companies was to produce enough milk to cover the base level of demand for fresh dairy products, such as

milk and yoghurt. They would then convert any milk produced above that level into longer life products such as cheese and SMP. The markets for products such as SMP, cheese and butter are becoming increasingly competitive and the profitability from these products is decreasing.

Controlling Supply

18. This decrease in profitability is forcing companies – and the JD is no exception here - to either specialise in certain products or develop differential pricing for milk at various times of the years. When used effectively, these policies “flatten” milk intake curves and better match supply with demand. While specialisation and outsourcing of milk supply provide best-practice examples, they are not tools that the Jersey industry can in its current situation easily use at the moment.

19. This is not least due to the historical development of the sector (i.e. no imports of liquid milk and the role of the JMMB as essentially a farmer facing organisation). The only option open to the JD to modify its current milk intake pattern is via strong seasonal price signals to farmers. The price signals given to farmers by the JMMB are weak in comparison to UK co-operatives and “plc” dairy companies alike. Making changes to milk intake through demand price signalling is a difficult, but not an impossible task. However, the impact of the above factors means that in the short term, the JD is likely to maintain its seasonal milk supply and therefore a requirement to convert seasonal buffer milk into long life products such as milk powders, butter or cheese etc.

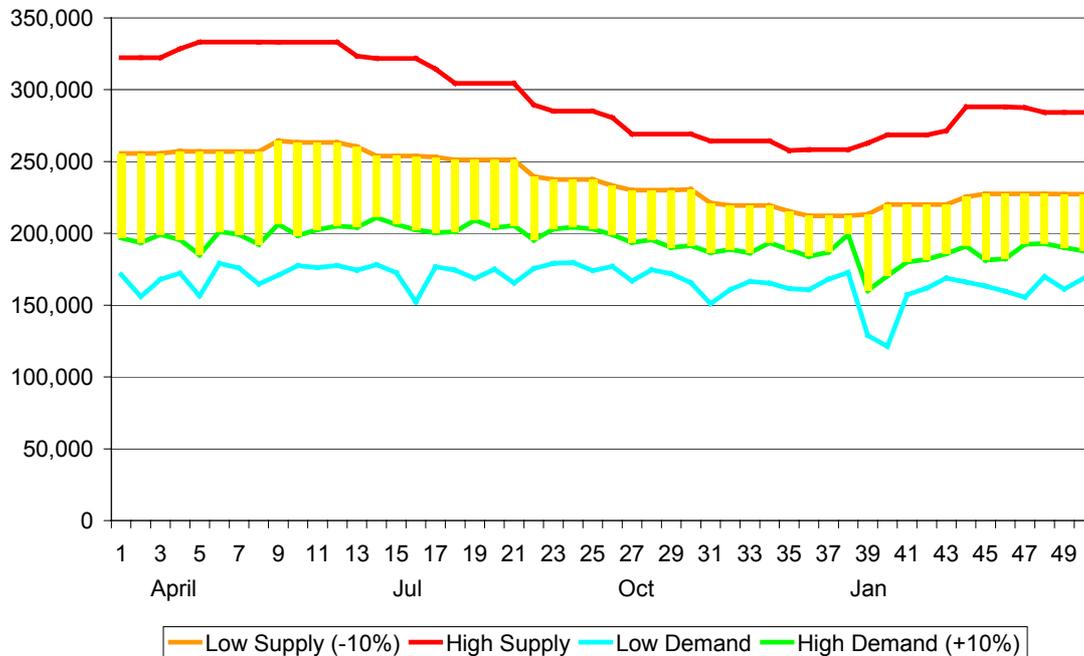
Matching Market Demand and Supply

20. Liquid milk dominates JD’s consumer products business and accounts for around 63% of whole milk intake. The need to satisfy liquid milk demand at all times, means that the JD has to run a larger than average buffer to ensure that there is always sufficient milk to cover possible variations in demand.

21. Combining the supply and demand curves along with our “worst case” buffer levels clearly indicates that at all times of the year there is a significant gap between demand for liquid and soft dairy products and raw milk intake (as shown by the bars in Figure B). This gap can be described as true “excess milk”. The degree to which this excess milk is defined as over an optimum level of production depends, in our view, largely dependent on the returns made from that excess milk.

Figure B - Jersey Dairy Supply and Demand

Worst Case: Jersey Dairy Supply & Demand



Market Returns

- 22. There is a wide range of gross profit levels made on the core product lines currently produced at the JD. Premium yoghurt is the most profitable item while SMP is the least profitable, and actually incurs a straight loss.
- 23. In an ideal world, 100% of the JD’s raw material intake would be allocated into product lines that provide a positive return. Under current conditions, these products would include cream, yoghurt, liquid milks, ice cream and retail packed butter. However, analysis of the JD production data indicates that substantial raw milk volumes (up to 25% of total intake) are being allocated to products such as SMP and bulk butter that currently provide a negative gross margin.
- 24. Given the current levels of excess milk, in most situations, the logical step would be to reduce milk intake immediately and then slowly rebuild milk volumes as the various initiatives listed above took affect. However, the closed nature of the Jersey dairy industry (particularly, the lack of milk-flow, and breeding stock in and out of the system) means that responses and strategies which work in the UK or elsewhere may not always work on Jersey. Given the above factors, the challenge for the JD is to fully implement the remaining elements of its dairy industry recovery plan - as quickly as possible.

Exports

25. One of the key components of the industry's recovery road map is the development of export markets. The market for commodity dairy products is extremely competitive and largely driven by supply and demand. Given the low cost basis and cyclical nature of these markets, it is highly unlikely that the Jersey dairy sector could profitably compete in this arena.
26. Competition amongst retailers and development of supermarket brands over the last 10 years has created massive competition for food manufacturers and squeezed margins to the minimum. Despite the challenges, development of consumer preference for products through development of strong brands remains a key method for food producers to gain an increased share of the final value of their product.
27. The JD's successful consumer business in Jersey provides a good test market and platform for expansion into retail markets outside Jersey. However, there a number of key challenges that the JD face in developing a retail presence in UK mainland and/or other international market. The "Jersey from Jersey" marketing message is potentially an attractive and unique proposition. However, it is not at this stage sufficiently unique or valuable to command a significant price premium in the market over and above that gained from other premium brands. The decision to target and develop the UK export market is a natural and logical decision for the Jersey dairy industry, but the limited resources available at the JD mean that the export development programme needs to be approached in a highly structured manner.

Future Options

28. There are a number of possible options for the future development of the Jersey milk marketing system. These are set out as follows along with the key points to take in to consideration for each:

Option 1 – Modifying the Current MMS

- this would see a change of the JMMB being a prescriptive monopoly to a statutory organisation
- it would in effect buy some time for the Jersey dairy sector, but probably not much more than this. This can only be justified if the time is used to maximum effect, and the key aspect here would be to be make full use of this time to build the new JD factory which is so badly needed

- however, it only deals with the internal threats that exist on the Island as to the position of the JMMB. It does absolutely nothing to deal with the threat of imported liquid milk, which is a critical issue for the successful development of the sector
- the JMMB and JD might well argue that protecting the domestic market in the short term is essential to allow them time to lower costs and develop export markets – and to a degree they are right. The reality is that the time they have to do this is beginning to slip away and action needs to be taken now to safeguard the future structure of the dairy sector
- the legal possibility of actually achieving this modification is not proven – and it may take some time (at least 6 – 9 months) to actually be put in place even if it can be achieved. It is likely that even if it were achievable, it would be challenged almost straight away
- another damaging and energy sapping legal case is the last thing that the Jersey dairy sector needs – not least it sends out very negative signals to potential customers, both on the Island and even more importantly potential new customers on the mainland
- it would also highlight the lack of internal certainty as to the future of the industry, one that is constantly under challenge and therefore produces a lack of confidence in the industry, low investment etc.
- rather than look to modify the existing scheme, the buying of time that is required can be achieved by the application of a PPE which will achieve the same end result but only for a specified time. However, again it does not deal with the real issue of beginning to position the Jersey dairy sector to deal with the external rather than the internal threats to the sector that exist and which are the real drivers for the mid to long term development of the industry
- there is only limited consumer benefit to be derived from Option 1, but government objectives – *brown cows in green fields* – are largely met. This option maximises the number of cows in Jersey and provides the highest (short term) returns at least to farmers

Option 2 - the JMMB Remains, But Only Deals with Liquid Milk

- Option 2 is what we believe to maybe be the “*worst of all worlds*” – the liquid milk market on the Island is still under the control of the JMMB. However, the JD has no opportunity to operate in the growth markets of exports to the UK and then the more modest growth that might be achieved in the local added value markets

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- the JMMB in effect remains a statutory type body for the local market. This option does nothing to deal with the threat of imported milk on to the Island and acts as a hindrance to exports. Cow numbers will decline over a period of time - as a result Government objectives – *green fields, brown cows* - will not be met. There are medium – high benefits to the consumer of seeing liquid milk prices reduced to potentially around 70 ppl.
- there will be an on going decline in cow numbers across the Island and as a result Government objectives – *green fields, brown cows* - will not be met
- however, in the mid to long term, the JD would begin to loose critical mass and even in the situation of Option 2, the role of the JMMB in the domestic market could well be challenged
- and as we have stated under Option 1, further damaging, expensive and energy sapping legal cases should be avoided, not least because of the negative signals it sends out to customers on the Island and the mainland too, as well as other key industry stakeholders

Option 3 – A Totally “Free Market”

- Option 3 for the Jersey dairy sector is in its current state, a “*short cut to disaster*”. The benefit to consumers is however high, milk is sourced at the lowest possible price, which might be in the region of between 45 – 65 ppl at the retail level
- however, the implication here is that all milk could be imported and in its current position, huge amounts of the local market would be lost in a very short space of time
- Farmers on Jersey would be exposed to the full force of EU and world market prices and would find it almost impossible to compete – many would be forced out of business
- there would be a significant fall out within the industry in terms of farmer numbers and the number of cows, and government objectives of - *brown cows in green fields* - will be tested to the very limit
- while consumers win, farmers lose out and the mid to long term sustainability of a dairy sector on Jersey is hugely compromised
- imports of liquid milk would dominate the market and over a period of time, extreme pressure from imports means that increasingly dairy farming on Jersey as it has been known becomes something of a “*museum piece – this is the way we used to do it*”

- even any possible advantage gained by the Government in terms of reduced subsidy to dairy farmers as they are forced to exit the sector would be negated by increased additional exposure to the running of the abattoir and the costs of increased payments to support better environmental practises

Option 4 - An Internally “Free – er” Market with Some Import Controls Removed

- Option 4 in effect produces the same end result as Option 3, only over a longer period of time. It does not position the dairy sector on Jersey to deal with the combination of imported liquid milk and the development of exports to the mainland – both of which we believe are the critical issues for the sector to deal with
- in the short term, it would probably produce a milk price war which is good for consumers but bad for dairy farmers and in the mid to long term might not even be that good for consumers either
- as the industry is forced to reconsolidate, it might be argued that it will eventually produce a “private monopoly” which would be ultimately challenged on a legal basis
- in reality, Option 4 for consumers produces a lower price for milk, but not the lowest. Over a period of time, cow numbers will be reduced putting Government objectives into some doubt. However, this decline will not be at the same rapid pace as seen in Options 2 and 3
- a fragmented industry, with no one single player being able to achieve a degree of critical mass will mean that the development of any exports business is put into severe doubt
- it might also be more difficult from a legal perspective to have a “semi free” market rather than a totally free one, not least in dealing with the question of if (and how) farmers not involved with the JMMB are regulated with milk licences
- something akin to a “half way house” scenario, Option 4 is most likely to produce a “slow route” to disaster rather than the “quick route” that would be produced under Option 3

Option 5 - The Development of a Farmer Controlled Business

Option 5 is the most appropriate for the dairy sector in Jersey to consider:

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- it provides a genuine long term solution for the industry but this is not to say it is without risk, and this is discussed later on – not least it requires a strong industry vision and leadership to “sell” the concept to the dairy sector and other key stakeholders on Jersey
- it is likely to address the concerns of organisations such as the JCRA
- a more competitive environment on the Island will see some consumer benefit in terms of milk price paid
- it is a proactive solution for the sector and avoids potentially further damaging internal legal action and/or having a solution and/or industry structure imposed on it externally
- it deals with both the internal and external issues confronting the sector, the development of exports and looking to produce a more efficient supply chain on the Island (i.e. more efficient farms and cows, a more efficient factory etc)
- the JD remaining a key player on the Island allows a degree of critical mass to be retained and cow numbers will be retained – having said this, Option 5 does not prevent farmers exiting the sector – and in the very short term, might even acerbate this
- it provides an opportunity to develop the new factory required and which is critical for exports, it also reduces the opportunity for asset stripping although a careful change over will be required here
- it needs to be achieved over a period of time in a controlled and managed fashion
- it represents something of a “new start” for the dairy sector and leaves behind much of the negative baggage of the past, despite some of the more positive changes of the last 2/3 years
- it has been achieved in other dairy producing countries – albeit it not without some pain

To pretend that this can all be achieved without some risk would be naive though. Some of the relevant issues here are discussed below. Essentially, these revolve around questions over industry vision and leadership, the building of the new dairy processing plant and the creation of export markets as well as how assets are protected and transferred during a period of change. Not least, careful consideration needs to be given as to what time frame is required to achieve this sort of change in industry structure and the future role of Government support.

Implementation - Leadership is Critical

29. Industry leadership needs to recognise that change is inevitable and this is driven largely by the external factors surrounding the unsustainability of a monopoly milk buying system, milk imports and the development of competitive exports to the mainland UK. The best option is to be proactive and manage the change, rather than have it forced on the Jersey industry by external industry stakeholders.
30. A proactive stance is we feel far more likely to have a positive overall impact rather than adopting one of “looking to protect what we have for as long as we can”. It is clear though that a realistic and planned timetable of change is required and this should probably be for between 2/3 years, but if it was possible to obtain further time, it should be taken. However, this programme of change should not be spun out and it is essential that any time available be made the very best use of.
31. The industry leadership also needs to sell the idea of controlled and managed proactive change to dairy farmers on the Island and provide the vision for the future that is credible with industry. The vision of a **single** united, strong, well equipped and market led co-operative as the best option needs to be sold to producers as it has been in other parts of the world in the run up to significant industry changes. The development of the Fonterra dairy organisation in New Zealand is a good example of this. While recognising that the scale of the New Zealand dairy sector is very different from that of Jersey, we believe that a number of similar analogies can be drawn vis a vis the development of the sector. Not least, Jersey should be looking to benchmark itself against the “best in class”, which the New Zealand dairy sector undoubtedly is.

Key Lessons from the UK

32. In terms of what can be learnt from the process of de regulation in other parts of the UK, these can be summarised as follows:
- maintaining processing capacity is essential. This needs to be agreed and ensured at the outset
 - this process takes time - unless it is well planned it could take at least 2/3 years to implement but to minimise time:
 - the industry needs to want the change and needs to convince the States of Jersey that it is a good idea to ensure that legislative changes are passed easily

- the States needs to ensure that the JMMB is aware of what is desirable and feasible in setting up a new structure as this will save time going through the process of public consultation
- the JMMB needs to put forward a sensible proposal for the new structure and one that is compliant with competition law etc.

How This Might Be Achieved In Jersey

33. There is a good deal of thinking to be done in Jersey before any major move is made in this direction, but a basic process could be as follows:

- the States of Jersey proposes a change from the JMMB to a FCB structure
- the JMMB puts forward a proposal and time frame
- the proposal goes out for consultation with key industry stakeholders
- the States of Jersey could then decide whether to change or not
- if the decision is “yes”, this would require a change in legislation

34. Multiple challenges provided by this change in the industry will need the maximum time possible to ensure success. As stated we believe this should be achieved over a period of 2 – 3 years but if more time can be gained, then it should be used provided it is used constructively and not as part of a “*spinning out process*”.

Government Support

35. Government should support the future development of the dairy sector in Jersey by providing assistance with:

- making a quick decision on the availability – once and for all – on the HDF site
- confirming on going support for dairy farmers as set out in past strategy documents
- granting a PPE for a specified period only to give the dairy sector at least some time to re adjust its structure and ensure that the new factory is built

- assisting with legal changes that might be required as part of the process of changing from a marketing board to a voluntary co operative
- providing export market development assistance funded by the Economic Development Department
- Government could (but only on a temporary basis) administer the licensing system to assist with the orderly transition within the Jersey dairy sector

The possibility of achieving what is a major change in the structure of the dairy sector on Jersey will be clearly enhanced by Government giving out clear, consistent and positive signals about the type, level and duration of support that the dairy sector can expect in the future.

36. We believe that the future structure of the industry in Jersey needs to look like this:

Big Picture Issues –Short Term Priorities

- a FCB structure should be created which over arches the wider Jersey dairy sector and industry
- the JD is still the key and pivotal organisation in the sector
- the factory will have eventually relocated to an efficient and functional (not automatically high tech) site
- after all commitments have been met there will not be much left over –if any at all - to pay out to farmers who want to exit the sector. The redevelopment of the factory has to come first as well as meeting other financial commitments. This might be unpopular, but is a harsh reality
- imported genetics are being used but as stated the full benefit of this will only be seen in the long term
- export development will have been developed to the mainland but probably not in short term. However, there is a need to keep trying in the short term gaining access to these markets is essential for future growth of the sector

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- Government objectives of “*brown cows in green fields*” are still met and there will be the opportunity for reduction in a number of government subsidies as farming gets more efficient in the future

Tactical and More Operational Issues

- shorter supply chains and direct contact between producer and processor are the way forward: the JD contracts with farmers on a direct basis for the milk that it needs and wants, rather than the milk it is forced to accept
- the industry over a period of time becomes more customer facing, and less inward looking
- there will be a smaller, but more efficient farm base maybe no more than 15 - 20 farms at some stage in the future but this depends on market forces
- farmers are more efficient in the future, better managed and in less need of government support
- new industry entrants are required as they are more likely to enter an industry which has a sense of real purpose in it than they are in its current state. At the moment, the decision not to enter the sector is just about as easy as it could be
- there will be a small number of dairy farmers operating outside the JD structure in non competing markets
- farmers that want to exit the sector have a way out through payments made from the sale of Five Oaks, but not nearly as much as expected and might be limited to buying up quota @ 20 p a litre and seeing them not reissued

Change Mechanisms

37. We see the challenge as not being so much as to reduce production to what might be seen as a more optimum level. “Excess production” is still being incurred, which suggests that farmers on the Island should be persuaded and/or encouraged to reduce production. However, we see it very much more as a problem less of having the “*wrong volume*” of production but more of the “*wrong type of production, at the wrong time*”.
38. The main option open to the JD to modify its current milk intake pattern is via strong seasonal price signals to farmers that reflect the real value of milk to the factory (and

ultimately the farmer in terms of product return). Making changes to milk intake through demand price signalling is a difficult, but not impossible task.

39. It will be important to maintain production at above the level required for just liquid milk market in the short term. This is not to give the chance for the JD to it can export to UK mainland. If it does not happen in the medium term, the JD might have to bite the bullet - and the industry goes into “*contraction*” mode of thinking.

3. BACKGROUND

3.1 The Way It Has Been

For hundreds of years, the Jersey cow and associated dairy sector have been inextricably linked to the Island of Jersey. The dairy value chain is still an important element of the overall make up of economic activity on the Island today. The Jersey Milk Marketing Board (JMMB) was first set up in 1955. Clearly since that time, much has changed both on and off the Island. In the mid 1950s, there were some 1,000 dairy holdings on the Island – today there are just 33. If the smaller size holdings are taken out of the equation, the reality is however, that there are only in the region of 25 working dairy farms on the Island per se.

Marketing boards, such as the JMMB, originally operated on a world wide basis – not just in the dairy sector – but in many other areas too – meat, fruits and vegetables and the cereals sector to name a few. They were formed in the UK, other European markets, New Zealand, Canada, Australia and South Africa and Israel, as well as other parts of the world. They were established for a number of reasons – not least to ensure adequate supplies of foods at what might be seen as “reasonable prices” to consumer (and to farmers too).

At that moment in time, this was the internationally accepted way of organising an agricultural sector, especially if it was involved in the export of agri food products.

However, the manner in which they were established was often in the favour of the primary producer. Based on our experience of working in a wide range of countries and agri food industries,² it is our experience that over a period of time, concerns were voiced that:

- they were often focused on meeting the needs of the producer - and not the consumer. For example in most cases, the selling price was set by the board concerned to reflect the local supply situation, rather than the international market reality. Produce was invariably “allocated” to customers rather than be subject to a wider sense of market demand and willingness to pay. Board structures often saw agri food industries ready to continue to operate as they had traditionally gone down rather than look to adopt new varietal developments and/or new methods of doing business with customers. In particular, the emergence of the main supermarkets found a rigid board structure increasingly inappropriate, and in some cases difficult to deal with. This has been

² This includes the UK, South Africa, Ireland, Cyprus, Israel, New Zealand, the Caribbean and involves the dairy, horticultural and meat sectors

especially the case for the premium niche retailers operating in the UK such as Waitrose and Marks & Spencer who required a more flexible procurement and trading arrangement with their supply chain partners. Being able to deal with the major retailers in an effective and efficient manner has become a reality for all agri food producers who want to operate in the UK and other international food markets – they hold the balance of power in the supply chain and require high levels of customer service and attention – which has often been found wanting amongst national marketing boards

- they were anti competitive (in that they prevented individual producers and/or other exporters from operating in the market place) in their very nature – even if they did not intentionally set out to be.....this situation resulted in a number of less than desirable situations arising, not least:
 - individual farmers and groups of farmers mounting legal challenges to the jurisdiction of the board concerned, leading to lengthy, costly and energy sapping disputes within the industry
 - distribution was often highly controlled amongst a strictly limited number of companies and which prevented true competition from taking place
 - a loss in some cases of international market share against fierce competition
 - a loss of competitiveness in the structure of primary production
 - a lack of new products and/or services being introduced to the market based on huge faith on the existing status quo and existing products
 - frustration from key international customers
 - frustration from other key industry stakeholders, not least government

Around the world, the role of monopoly marketing boards has increasingly been seen as “not the way to do it (anymore)”. This has been in response to pressure from across the whole value chain – from primary producers, from exporters and major customers in target markets. Governments around the world have also been forced to look carefully at:

- their role in terms of legal positioning vis a vis local and international law
- the overall cost of supporting their agricultural and primary food sectors per se (which might include direct or indirect support to a national marketing board)

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- whether these types of organisations meet the needs of both their primary producers and the major customers that they service in international markets

Not least, pressure has also come from organisations such as the World Trade Organisation, the Cairns Group and the EU Commission who have seen them as being anti competitive in terms of the influence they might be able to exert in (distorting) trade in international agri food commodity markets. The Canadian Wheat Board is often cited as the worst case example of this.

In the period of the 1950s, the use of national marketing boards was regarded as an appropriate way of organising an agricultural industry, and met the legal requirements of the time. However, for a range of legal and commercial reasons, the day of the national marketing board in agriculture and food seems to be well and truly over.

As a result of all these pressures, ranging from legal viability, the cost and type of support given to the agricultural sector per se by government organisations and then their ability to satisfy the range of commercial and technical demands made upon them by:

- primary producers
- intermediary organisations in the supply chain
- major end user customers

.....national marketing boards have been disbanded in many countries around the world in countries and industries such as:

- New Zealand – fruit and dairy
- Ireland – dairy
- Israel – fruit
- Canada – wheat
- Cyprus – dairy and horticulture
- the UK – all major agricultural commodities, including milk

It is noted that in some countries and regions of the world, marketing boards have been retained and/or had their functions re organised – examples exist in North America in particular. The Dairy Farmers of Ontario is one of these organisations. A few small scale industries (such as the dairy sectors in Guernsey and the Isle of Man) also have in place similar arrangements as Jersey. However, it should be noted that in most cases, these structures are very much the exception rather than the rule. It should also be noted that over the last 20 years, none of these structures have actually been created.

None of this deregulation has happened easily - there has been pain experienced across the supply chain in the process. Primary producers have, in some cases, been less able to operate in an environment, which is less protected than in the past. Some have been forced out of business. Some would have been forced out of business anyway.

New processing and exporting operations have invariably emerged in a de regulated structure – not least at times, flushed with the opportunity to do it “*their way*” and make good where the marketing board in the past has been perceived as letting them down. It has often not been easy as might have been expected. ***Many have found that the transition from “protected farmer” to “entrepreneurial processors and marketer” is a very difficult one to make effectively.***

Much of the success or otherwise of the deregulation process can be traced back to how this has been managed over the period of adjustment and any change in our view that might eventually be required in Jersey will need to take this into account. Certainly, change for the sake of change should be avoided, as should any dramatic short term change. Not least we feel that the industry is not in a robust enough state to withstand and sort of short, sharp shock to it.

Any change in the structure of the sector now or in the future will need a combination of:

- clear communication to the value chain as to what will happen, when and why
- strong industry leadership to manage this change and build a new vision of how the sector might look in the future
- a planned programme of change over a period of maybe 2 – 3 years: if more time can be gained it should be taken but not just to “spin the process out”
- time for those in the value chain to adjust and plan accordingly what their response is

However, the reality is that whatever internal structure emerges over a period of time needs to be able to face up to the external challenges that face the sector. These are the threat of what happens when (not if) imports of liquid milk come to the Island and the need to build exports to sustain growth of the dairy sector per se – both of these are discussed in more detail later on in this report.

Different country, different products, same process, same outcome ? What has happened elsewhere ?

In South Africa, when the fruit export sector was de regulated in the late 1990s, the industry structure went from one monopoly supplier, the national marketing board, dealing with all customers in all international markets (called Capespan International) to over 180 registered exporters of a full range of horticultural products.

5 years later, the structure had reverted to around 40 registered exporters, but with the top 5/6 players accounting for c. 80% of the exports. Capespan International is still the largest grower and exporter in the country and is seen by customers in particular – for which the demanding UK market for them is totally key – as being a leaner, meaner and more responsive organisation than it ever was in the past.

As a result, it now regarded as much more customer focused organisation and developed new markets in the US, Asia and other parts of Africa as well as developing joint ventures with other producing countries to give better all round seasonality of supply.

A major fruit and food company operating in Ireland and the UK has acquired a significant shareholding in the business, and it is now jointly owned by this company and SA based fruit producers.

3.2 The Way It Is Now

Back in the 1950s, supermarkets as we know them to day did not exist – consumers still purchased fresh foods on a daily basis from local corner shops, there was no internet shopping, no probiotic yoghurts and no big fuss made about “local sourcing” and “regional (and sub regional) provenance”.

The entire situation regarding production and marketing in the international agricultural and food sector has changed out of all recognition. Markets have been gradually liberalised, and are fiercely competitive - and many, if not all, the agricultural marketing boards have been de regulated around the world. Markets for agricultural inputs and outputs have been gradually

subjected to the huge forces of globalisation – and major international customers, primary producers and processors are invariably engaged in the search for partners in the supply chain which are seen as being “best of class”. In many cases, the exact (geographic) location of these supply chain partners is becoming incidental.

Against this background - of highly competitive international food markets, de regulated markets and less protection for primary producers and a reduction – or in some cases a total removal of the monopoly powers marketing boards, the Jersey dairy sector has existed. It has been under constant pressure. The JMMB has remained in place. It has made some changes to the way it operates, but in many ways performing the same basic function as it did back in 1955.

It would appear that in effect, the Jersey dairy sector has been operating in isolation from the rest of the UK and other European markets for most of the last 25 years and more. It is understood why this has been the case in the past but we believe it is more important is to consider whether this can be the case in the future.

For example:

- there are no imports of liquid milk allowed on to the Island
- there have been no imports of genetics on to the Island
- the statutory marketing board has remained in place, through a combination of choice and because of the actual law in Jersey itself. Regardless of the reasons behind this, the reality is that the JMMB has remained in situ
- the main processing facility on the Island is now out of date and unlikely to meet the exacting technical demands of potential major retailers on the UK mainland
- there has, in effect, been a protected local market for liquid milk, but with a good degree of loyalty from key customers on the Island still evident
- there have been few exports to the mainland – the mini pots contract seems to be the only success here – and the loss of this business saw a significant reduction of the Island’s production capacity. It was lost for a number of reasons – but not least because of the fact that the industry on Jersey could not compete against aggressive competition from the Irish dairy sector
- there has been ongoing decline in dairy farm numbers

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- the dairy industry is heavily protected and subsidised in comparison to its counterparts on the mainland UK

The Jersey dairy industry still displays numerous large signs of being production driven – with a limited historical market focus – although under new management at the JD, this is beginning to change. We would be the first to acknowledge that the current management team has made strenuous efforts to improve the situation that they inherited several years ago.

Progress has clearly been made in areas such as reducing processing costs, reducing the staff numbers at the JD factory (always regrettable, but a fact of life if an efficient factory is to be run), the reduction of debt and the maintenance of liquid milk selling prices. However, it also clear that still much needs to be done and the external challenges to the business will not go away.

The situation that the current management of the JMMB and the JD find themselves in has much to do with the historical way in which the business has been run over many years. Mistakes might have been made, but there has been progress in the last 3 years. However, what cannot be denied is that due to the way the business was managed in the past, they are in effect “starting from a long way back”.

3.3 The Way It Might Be

There are a whole plethora of challenges to the future of the dairy sector on Jersey that have to be faced up to in the next few years ahead – and in some cases the timespan is much shorter.

These include the following:

- a ruling likely on the status of the JMMB as a monopoly buyer and seller of milk on the Island in light of challenges to this position from individual farmers
- challenges that might be made on the import of liquid milk
- farmers will continue to exit the sector at least at the current/recent rate
- a leading UK and/or French retailer comes in to the market in Jersey – and changes the face of the industry
- there is an aspiration to export from the JD – but the physical infrastructure is not in place to meet customer demands on the mainland

- there is need for better genetics to survive – even if it takes 10 years to see the full benefit of this and the ban on imports on to the Island is challenged
- the JD factory is increasingly inappropriate for the customers it wants to serve
- *it is inconceivable that this situation of operating in isolation of the UK and other EU markets will be allowed to continue, can continue - and/or is even desirable*
- the States of Jersey wants to preserve “brown cows in green fields” and a sustainable industry on the Island. Support will be given to an industry which addresses its own key issues and looks as if it is prepared to continue moving forward

The Last Few Years v. the Previous 40.....

The JMMB and JD has in the last few years begun to make progress on this front – but as mentioned earlier on – is “starting, in effect, from a long way back”. This is not an implied criticism of the current management, but more of an indication of the way things have been run and managed in the past.

What it does not change is the fact that the JMMB and JD are still faced with a very difficult job in hand. They must face up to a range of external challenges to the business which cannot be dealt with in the same way that some of the internal challenges to the dairy sector in Jersey can (i.e. revert to a drawn out legal process)

- there are too many challenges to the Jersey dairy sector – with the implications being too significant in terms of impact – to carry on along the somewhat isolation route it has followed for too much longer
- many of the issues are inter linked – especially vis a vis imports of liquid milk, breeding material and the position of the JMMB as a monopoly player in the supply of milk on the Island – and there is a danger of a “domino effect” taking place. Dealing with just one of the issues and hoping that the others will “go away” is not likely to work

A Saving Grace – Time ?

Some of these factors still might take quite a long time to take full effect. There is therefore the advantage of having some time on the side of the industry – but this must be made full advantage of and not wasted if the industry is to successfully restructure as it will inevitably be required to do so.

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The time available might be as much as 2/3 - 5 years, depending on what might be the outcome of any legal decisions made in Jersey over the next few months on the status of the JMMB, as well as the potential threat from imported liquid milk – but this should not be abused. At this stage, the dairy industry in Jersey is not in a strong position to take any high risk options – and in our view, relatively low risk - but decisive action is required for the future.

4. THE JERSEY MILK MARKETING SCHEME

4.1 Background

We have already mentioned the background to the development of national agricultural and food sector marketing boards, which can be summarised as:

- **1950's** – *“the way to do it”* – most agricultural producing countries had them across most sectors
- **1990s and on** – *“not the way to do it (anymore)”* – most, if not all have disbanded them and/or altered their role – away from commercial trading, towards industry representation, promotion and R & D services etc. None of this change has been made without a degree of pain across the supply chain.

For example:

- the JMMB was formed some 50 years ago – but the world has changed a huge amount in the last 10 years, let alone 50, not least in the way that modern food retailers want to do business with their suppliers and the technical and commercial demands that they make on them. In Jersey, the number of dairy farmers has dropped from 1,000 down to just over 30
- a monopoly board structure is increasingly out of touch with a modern and efficient farming and food processing industry that has to compete against other internationally based farmers and processors – as well as (in some cases) for a share of the public purse too. Major retail and foodservice customers are looking for streamlined relationships with progressively minded and customer focused businesses who are extremely responsive to market demand and supply as well as the process of new product development and innovation, as well as high levels of commercial flexibility
- few other agri food sectors in the world have kept these structures. Dismantling them has been sometimes been painful and caused hardship in the short term but in the end, has invariably produced a more streamlined and efficient sector for those that “remain in play”. A small number of marketing board type organisations still exist, some of the best known are in Canada, as an example, but they have been subject to review in terms of function and structure on a regular basis. Some small Island economies such as the Isle of Man and Guernsey have retained broadly similar structures to Jersey, but the “best in

class” as found in New Zealand, the US, Denmark and Holland³ have long since moved on in terms of industry structure and management. What is also clear is that in the last 10 – 20 years, none of these boards have actually been created

- how this is done is critical – do you go for the short sharp shock or programme of managed change ? Arguments can exist for both, but the Jersey dairy sector is not in robust health and might not cope with the “short, sharp shock.....”
- marketing boards are seen as an inefficient way of doing business – the rest of world in most (although we recognise, not all countries) is going to short supply chains and direct market messages from processors to farmers – the JMMB and the way it operates is not facilitating this - and indeed maybe even be blocking it. As an example, the way that the contracts between farmers and the JMMB operate is discussed in more detail in this section of the report. However, as a general comment, we believe they send out a mixed message and or in some cases, the wrong message to farmers
- UK mainland co operatives and plc’s alike in the dairy sector are very aggressive in the purchase of milk, price setting and encouraging supply when they want it and perhaps even more importantly - *when they do not want it* – they are not least strong on secondary balancing and processing
- the JMMB and by implication, the JD is very weak in this respect – they are forced to buy and then process whatever comes their way
- marketing boards tend not to be market focused - contracts usually favour farmers, not customers – from the business of farm gate and factory procurement through to dealing with the retailer
- the JMMB was formed in 1955 for the right reasons – but these are no longer applicable in the year 2006. This is not least because of the huge external threat that hangs over the industry in the form of the need to deal with the likelihood of liquid milk imports coming onto the Island and the need to develop exports to the UK mainland. It is also critical to take into account the legal challenges being mounted against the role of the JMMB and the need to demonstrate legal compliance to the likes of JCRA. The external challenges

³ We believe that Jersey has far more to learn from what might be seen as the “best of class” such as New Zealand, Denmark, Holland etc rather than the “rest”, whilst of course acknowledging that the scale of activity is much smaller in Jersey – we feel that valuable lessons can be still be learnt

to the industry are essential to face up to if there is to be a sustainable dairy industry on the Island

- the JMMB is probably not sustainable in the future in its current form – and in any case it will be challenged by the JCRA

In terms of **specific weaknesses** in the way that the JMMB operates, the following are important to note:

4.2 Milk Prices

The milk price is the one area where the milk buyer can directly influence the supply of milk coming forward, to incentivise those aspects with enhanced market value, and to give the producer the market signals of where to change.

The JMMB contract lacks many of these aspects, though they do appear to be starting to change with their 2006-7 schedule.

4.3 Butterfat Bonus and Deductions

The JMMB pay an incentive for butterfat content of milk, of 0.5p per 0.2% above 5.4% (and from April 2007 the same level of deduction for milk with butterfat contents below this 5.4% level). This is 2.5p per 1%, or £2,500 per tonne of pure butterfat. But, the JD sell their wholesale bulk butter (with about 82% butterfat content) at £1,500 per tonne. Clearly, JD lose money on every extra kilo of extra butter produced.

In contrast, the leading UK dairy companies have aligned their farmer milk quality payments more in line with the falling cream and butter market values. The three major companies that supply liquid milk to mainland retailers pay as follows:

- Arla pay 0.5p per % over 3.70% butterfat milk, or £500 per tonne of butterfat
- Dairy Crest pay 1.70 per % up to 4.15% butterfat milk, and then no more
- Wiseman pay 1.5p per % over 3.5% butterfat milk, or £1500 per tonne of butterfat

In terms of the reaction from the supply chain, farmers can adjust the butterfat content of milk by changing their animal nutrition. The simplest modern methods allow this to happen without changing from say silage to hay diets. Feeding a pure palm oil supplement will raise

butterfat percentage by 0.2 – 0.4 points (viz. from say 5.2% to 5.4% fat content or better). It works, because palm oil is a C16 fat, and this is also a constituent of cows butterfat output. This C16 fat can be incorporated in the dairy concentrate feed for a cost of £16 per tonne on the Island. The typical practical outcome is that farmer's feed cost will rise, which will earn a milk price bonus that will just about pay for it, but the JD will lose money on each extra kilo of fat sent to it to sell.

This is – in our opinion - the completely wrong market signal to give to dairy farmers.

4.4 Total Viable Bacteria Count (TVC)

This is important to a dairy supplying the liquid milk market, as it is a key influence upon prolonging the shelf life of milk for retailer and customer. This has only recently been introduced by JMMB. A clear comparison with the UK is not quite as easy, as most UK dairies use a slightly different hygiene measurement. The JMMB have a 0.5ppl bonus for the top band of 0-5,000 cells, and a penalty deduction of 0.8ppl for 50,000-100,000 cells, a spread of just 1.3ppl between top and bottom hygiene quality milk. Only 14 out of 33 Jersey milk producers averaged less than 5,000 TVC in the last milk year to 31.3.2006.

In contrast with the JMMB, leading UK milk companies operate as follows:

- Arla have a spread of +0.5 for the top to - 6ppl for the bottom quality band
- Dairy Crest have a spread of +0 to -15ppl for the bottom band, and
- Wiseman have a spread of +1ppl to – 5ppl for the bottom band

These are infinitely clearer market signals than those of the JMMB, that only top hygiene milk is wanted for liquid markets.

4.5 Somatic Cell Count

The average SCC in Jersey is 205,000 compared to 193,000 in the UK, with only 18 Jersey producers able to average less than 200,000 in the milk year to 31.3.2006. The JMMB and UK bonuses are directly comparable, though the levels at which the bonuses change are different – see Table I on the following page.

Table I - Somatic Cell Count Payments

JMMB		Arla		Dairy Crest		Wiseman	
Range	Bonus	Range	Bonus	Range	Bonus	Range	Bonus
0-100	+1.0	0-200	+0.6	0-200	0	0-250	+1.0
100-150	+0.7	200-250	+0.3	N/a	N/a	N/a	N/a
150-200	+0.3	250-300	0	N/a	N/a	N/a	N/a
200-300	0	300-350	-2.0	200-250	-0.2	250-300	0
300-400	-0.5	350-400	-5.0	250-400	-0.5	300-400	-2.0

N/a – not applicable

The spread between top and bottom bands is just 1.5ppl for JMMB, but is still significantly tougher in most UK contracts – Dairy Crest is one of the gentler in this regard. Wiseman has a 10 ppl penalty for any milk over 400,000, and Dairy Crest has a 15 ppl penalty – and that is also the level above which milk should not legally be collected in EU countries.

4.6 Transport Costs

Most UK milk buyers have a fixed transport charge per collection ex farm, generally the same for all, and which encourages alternate day collection. This flat rate “stop charge” also means that the larger farms are not subsidising the collection costs for the smaller farms.

The JMMB has no such collection or stop charge.

4.7 Seasonality

Seasonal price bonuses have been used for very many years in the UK to try to encourage milk production in those months where supply is weakest. Conversely deductions are made when the peak milk supply has no valued market, or worse, no capacity to even process it.

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Table 2 - Seasonality Payments

Daily Milk Production (expressed as a percentage of the Annual Average)		
	Jersey 2005/6	UK 2005/6
January	92.1	97.8
February	95.0	99.7
March	97.5	106.6
April	104.1	107.4
May	108.5	110.2
June	111.4	105.7
July	107.8	100.3
August	109.3	97.9
September	103.7	95.0
October	94.6	92.8
November	89.4	91.8
December	86.4	94.5

The JMJB has only reintroduced seasonal price differentials in Jersey. From the table above, the seasonal milk supply for Jersey is similar to the UK, but with a slightly higher summer peak, and a deeper mid winter trough.

However, the bonus and penalties on offer by the JMJB contract are very gentle in comparison to most of the UK milk buyers, and are probably insufficient to financially influence when farmers calve their cows and heifers.

Table 3 - Seasonality Pricing

	Seasonal Milk Price Bonuses and Deductions		
	Jersey	Wiseman	Dairy Crest
Spring peak	- 0.5ppl	- 3.0ppl	- 2.5ppl
Autumn bonus	+1.0ppl	+2.0ppl	+2.0ppl

Some of the major UK dairy companies also employ band pricing mechanisms to encourage a flat milk supply, and discourage a change to more seasonal calving patterns. This may be in addition to the sort of seasonal bonuses above (such as for supplies to Dairy Crest) or instead of (such as Milk Link with their “A and B” milk prices). The market message to UK farmers is very clear – your extra spring peak milk is unwanted, and has very little real value.

Implications for the Jersey Sector

The same is true for the market value of surplus milk sent to the JD, but the price consequence of sending extra unwanted peak spring milk to make the lowest value milk powder in Europe is not fed back to those producers who sold the milk.

All of the JMMB market price signals to producers are still in our view too weak, though we would recognise that under the current management they are changing and we understand that there are further plans to introduce more meaningful contract terms. Our concern is that this might be a case of too little, too late.

5. THE INDUSTRY RECOVERY PLAN

5.1 Introduction

The broad principles of the JMMB business plan for recovery are laid out by the JMMB in documents to support their application to the Minister for Economic Development for exemption under articles 12 and 18 of the Competition Law (Jersey) 2005.

The strategy is – on paper - relatively straightforward:

- to raise capital by getting planning permission for the current JD site at the Five Oaks Dairy
- to use some of this capital to build a new dairy complex at a site on HDF
- to use some of the money raised to repay some (or all) of the current bank borrowings
- to maintain the liquid milk business, but to change the product mix of the balancing milk supply from bulk butter and dried milk powder to catering pack butter and cheese
- to build an export market for high value milk products, mainly yoghurt

The increase in plant efficiencies, finishing the current loss making activities of milk powder and bulk butter, the savings in bank interest charges, and the new high value export markets will all contribute to a bigger planned divisible surplus of £1.23 million.

There is one further element of the strategy, which is to improve the Jersey cow genetic efficiency by semen imports, to reduce on farm production costs by £0.58 million, worth 4 ppl over 14.5million litres. However, this is not within the JMMB remit to deliver, and would involve a change in Jersey Law.

As is often the case – the theory of the strategy is relatively straightforward and to our mind makes a good deal of sense - but the actual implementation of it will prove to be more difficult.

5.2 The Five Oaks Dairy

The current dairy is 40 years old. It needs substantial investment in order to replace some of the very inefficient manufacturing equipment. The main dairy building has been added to over many years, resulting in an inefficient flow of raw materials, packaging, finished products, and refrigerated storage being all over the site. These are two of the primary causes of the plants current high operating costs. Not least, the buildings themselves are increasingly costly to maintain, with multiple old flat roofed buildings and inadequate drainage.

The dairy as it is currently, will not easily pass the sort of quality assurance inspection that the higher value market buyers (e.g. Waitrose, Marks and Spencer) would expect from their suppliers. In time, these standards are likely to be expected by most major retailers on the mainland.

The dairy site is currently designated as land for industrial use, but is actually surrounded by houses, and lies beside a countryside area of high amenity value to the east. It has been indicated to us that planning permission for housing on this site is highly likely, subject to all of the usual planning laws. Permission for a supermarket or retail park is unlikely.

The indicative value of such a site could be around £9 million, and so the first aspect of strategy would work. But it might be lower - depending on what the site is finally used for.

At this point, there is a danger that some disaffected dairy farmers could demand a poll to revoke the JMMB. Such a poll would need only 9 dairy farmers to call for such a meeting although it would need a majority of producers to go as far as to come to a decision to wind up the JMMB is passed in a general meeting. The net assets of the JMMB would then “be distributed in such manner as the registered producers in general meeting shall determine.”

With planning consent, the JMMB net assets would be in the region of £6.5 million, after the pension deficit and redundancy costs are paid. That is a lot of cash to divide between 33 dairy farmers. While maybe good news for the 33 dairy farmers on the Island, it would be a severe hammer blow to the future development of the Island’s dairy sector. It would also be a major threat to the stated intention of governments to have an Island with “brown cows in green fields”. If the industry in Jersey is to move forward at all, this situation whereby the assets of the JMMB are sold off and divided amongst the 33 dairy farmers should be resisted.

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Assuming that the above revocation does not happen, then the strategy is to relocate JD to the HDF site, where they have successfully gained full planning consent for the new factory. The proposed new dairy was costed at £6.25 million in 2004, plus the purchase price of the site of £0.75 million, a total of £7.0 million. This build estimate may well have risen by perhaps 10% by 2007, to £7.62 million.

The potential sale price of the Five Oaks current site is around £9 million, leaving perhaps £1.4 million for debt reduction. If there are cost overruns, further delays, unexpected costs (which would not be at all unusual), then there may be little –or indeed nothing left over left for debt reduction. And this assumes that the site at Five Oaks is sold for a relatively high value – if for whatever reason, it was sold at a slightly lower value, there maybe nil left over for any debt reduction.

The idea that the sale of the Five Oaks Site solves all of the problems of the JMMB and the JD seems somewhat fanciful. The interest saved on debt is not the major part of the recovery plan, but it does amount to £72,000 of planned cost saving. Although the sale at the HDF is agreed at the last site valuation of £750,000, there has been some disquiet about the sale on two grounds:

- there is a restrictive covenant from the original benefactor that the HDF site should be only used for education in farming practices
- there is concern from the States public accounts committee that the value is not wholly commercial

Both of these issues could, we believe, be circumvented by JMMB leasing the HDF site, rather than purchasing it, but they would still be operating physically very close to those watching its operation and performance. There is some dispute as to whether leasing would circumvent the restrictive covenant issue. To our mind though, the most important element of all this is:

- the HDF site is available
- the HDF site is suitable for a modern and efficient processing factory
- factory plans have been drawn up and site appraisal work carried out
- the JD desperately needs a new site especially if the export business to the mainland is to be built and we believe that this is critical for the future

- any further delay on a decision is not at all helpful as it will cause further delay to the development of exports, it will be a further drain on the confidence of the farming sector on the Island and will possibly act as a disincentive to JMMB and JD management

The site is fit for purpose, it is available and our advice is to sort out the remaining legal issues once and for all. Get on and build as soon as possible at the HDF site.

On both of the two issues above, there is alleged to be disagreement amongst those who will have to make the final decision on whether the sale goes ahead. Whilst there appears to be some sympathy for the JMMB, and that they have been led to this apparent “easy” solution to their quest for a new dairy site, the view now appears to be that it is unlikely to happen, at least in the short term.

As stated, we believe that on going delays in the search and identification of a new site for the JD will prove to be very damaging.

The JD is desperately searching for new markets and indeed these are critical to its future evolution and the future well being of the industry per se – the factory they operate from is not going to help them achieve this at all. It is inefficient, old fashioned, would not pass a stringent quality assurance inspection from a major mainland customer.

It produces the wrong combination of products at non-competitive prices. The JD has to move. And further delays to this situation will only make the current situation worse.

5.3 Other Site Options

Up until recently, it would appear that the JMMB had not developed any alternative plans for relocation, and had put all of their redevelopment plans - and costs - in the one basket of a new dairy at the HDF.

There are two other distinct possibilities for dairy redevelopment - sell part of the existing site, and reinvest in a smaller dairy on the current Five Oaks site. Or move to the dairy to another location altogether.

Planning permission for housing development on just the southerly part of the Five Oaks site is also very probable, and could release in excess of £4 million net for factory redevelopment on the rest of the site. This might be a little more if sensitive plans can be put forward for the

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small area further to the south of the above area now designated as industrial, which is currently scheduled as a “presumption against development” area.

There is at this stage no costing available for this option, but as complete refurbishment of old buildings often cost nearly as much as new build, there may be little difference to the new build estimate above apart from buying the site. This may leave no spare cash for the JD debt repayment part of the strategy, and the HSBC bank may well have a view on the desirability of this option, as they have the land as security for the loans currently made to JD.

It also does not get away from the fact that in our view, the Five Oaks factory is increasingly inappropriate for a modern and efficient food processing site and activity per se. This is regardless of whatever you might do there to re invest and bring up to the exacting technical standards required by a major retail customer on the mainland.

Planning for a new dairy in another location altogether, on a site of existing farm buildings is also a strong possibility, with planning for change of use from farming, to food processing being a straightforward planning decision - we are led to believe. This would allow the full release of capital from the Five Oaks site, and allow full development of a new dairy.

The dairy build plans are written, and so need only a little adjustment (and cost) to suit any new site. Planning for the new dairy site to be “leasehold” rather than purchased would also release capital, but at the expense of another large operating cost replacing the bank interest charges, but with no capital loan repayment as now. There is however no need for Jersey Milk to be a business with capital asset growth for its working capital. Buying the new site is also an option – and one that should be seriously considered. The overall costs between leasing and buying are probably over a period of time not that much different.

Leasing might be the less risky to the JD in the short term but buying out right might give more stability in the mid to long term. It also reduces the chance of a small number of farmers making a move for what might be seen as a “cash pile” resulting from the sale of the Five Oaks site.

In summary:

- the existing Five Oaks site is inappropriate – the wrong size, shape, outdated factory equipment, in the middle of a residential area, and unlikely to give new mainland customers too much confidence (if any)
- its main advantage is the potential value of the land - estimated to be in the region of between £8 – 10 million

- other options are limitedbut the HDF option is still by far the “best bet” and this needs to be implemented as soon as possible
- the idea that there is going to be a lot of money (if any at all) “left over” to “pay out” to farmers who might want to take the opportunity to exit the industry is false. Once the site has been sold, some debt paid off and other considerations – there is probably going to be very little left over (if any) at all. It will need the Five Oaks site to be sold at maximum price and the new factory to be built totally in line with budget if there is any hope of this happening. Our experience is that a cautious view should be taken – selling Five Oaks at a low price and building at a cost of plus 10% on budget at least
- any factory built should be on a low risk basis – a flexible future development plan allowing for expansion in line with customer demand. Initially it should be built on the basis of known customer and market demand at the time – not on the basis of “jam tomorrow” – but it does need to allow for expansion
- renting or leasing the site on a long term lease might appear to be better than outright purchase and give more flexibility, but there are plenty of good businesses run on debt. If it was that the site was purchased outright. Not least, this gives the factory the chance to borrow in the future for further expansion that might be planned and/or needed
- any new factory should not automatically be state of the art, but primarily functional and efficient. It should be a “working factory” aimed at producing efficient dairy products
- the longer it takes to make a decision, the more difficult it will become to actually implement – there is a need to make a decision for all involved in the reasonably near future

An efficient factory on the Island is pre requisite for future success. Five Oaks does not give this. A move – sooner rather than later is required. HDF is by far the best option and this should be implemented as soon as is possible.

5.4 Better Genetics

This is one of the “hot topics” in the Jersey dairy sector. It produces extreme views on both sides – and which are passionately held. Unfortunately, there is no common middle ground which would make a decision on whether to allow imports of breeding materials (or not).

The Jersey dairy herd has been closed for approximately 200 years, with no imports of genetics. During the majority of this period, the Island was able to export surplus breeding

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stock to other countries, so providing a significant source of additional income. The Jersey breed is now the second largest breed of dairy cattle in the world, with substantial populations in many parts of the world, including New Zealand, the US, Denmark, the UK, as well as in many other countries. The success of the breed has meant that many countries have been able to develop their own selection programmes.

The use of imported genetics to guard against in - breeding within the Island population or to improve specific traits has been considered on several occasions, the most recent of which was in 2003. This followed the production of a very thorough report into this issue by Dr Maurice Bichard, entitled “*Sustainable Development of the Island’s Dairy Cattle*”.

This report made the following (clear) recommendations:

“.....the clear conclusion is that RJAHS should recognise that it cannot operate an internationally competitive closed breed improvement scheme for the Island’s cattle. It would be of benefit to Island farmers and their customers if importation of Jersey breed semen (frozen) were permitted with due attention to the exclusion of disease. It is recommended that applications be made to the States to revoke the long-standing prohibition on such imports. Importation should preferably be under the control of individual herd owners, or failing that, of RJAHS. If importation is not to be allowed, then RJAHS should try to organise a new closed improvement scheme based upon the widespread use of selected young sires.....”

It is clear from the farmer interviews that there are still strong opinions both in favour of, and against, lifting the ban on imported genetics.

The view that the Island does not need the extra milk that is likely to result from the import of genetics is one that is hard to justify. This is because the imported genetics would enable farmers to either produce the same amount of milk from less cows (Option 1), or to maintain a similar number of cows producing a similar milk yield but using less feed (Option 2). There is particular merit to both of these options on Jersey because of the low value of cull cows and calves (Option 1), and because of the high cost of imported feed (Option 2).

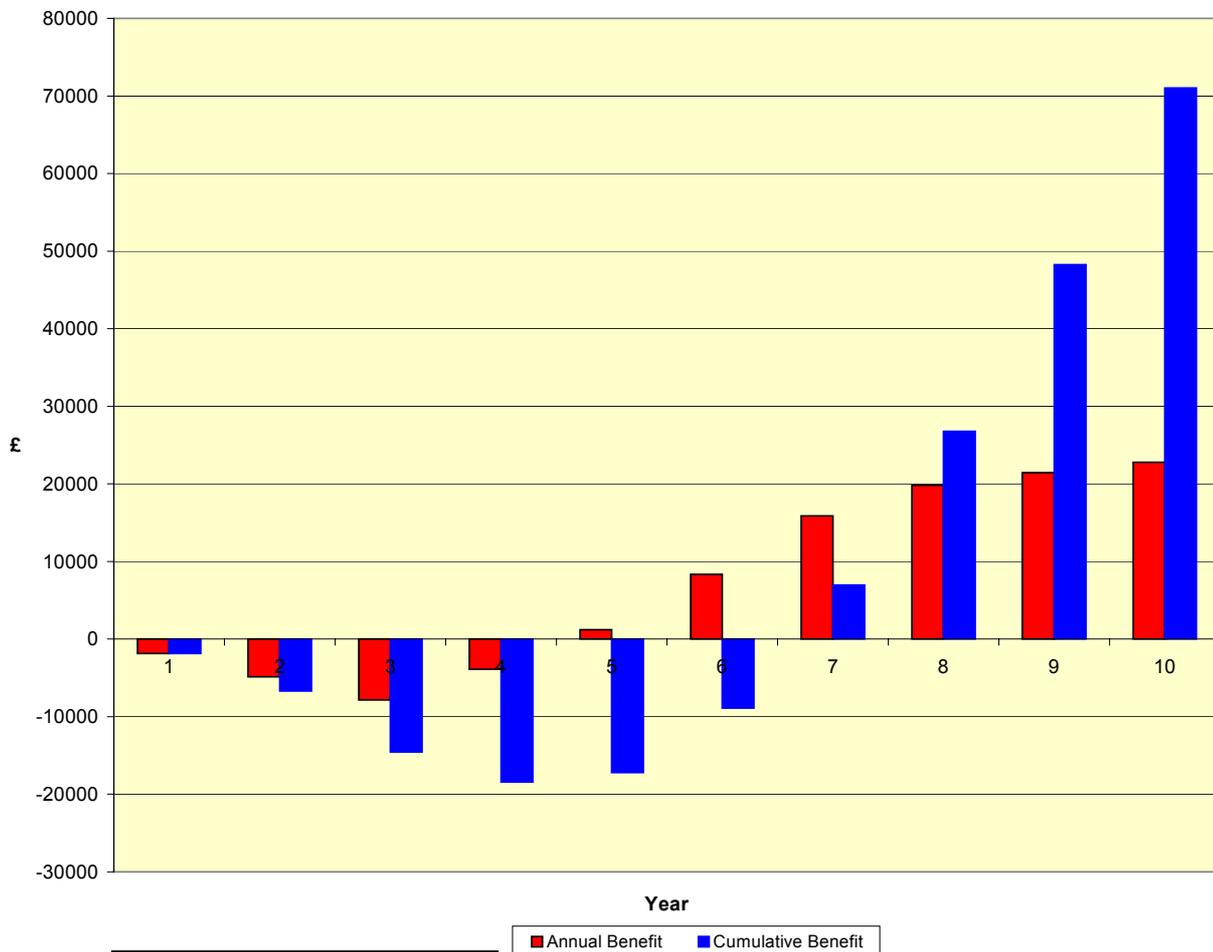
The idea that the retention of the Island Jersey gene pool is of crucial importance can only be justified if there is a dairy industry on the Island, sufficient to justify the continuation of the Island breed. The lack of exports of livestock from the Island in recent years shows that dairy farmers in other countries currently place little value on the use of Jersey Island genetics. In the event that there are genes contained within the Island herd that may have value at a future date, there are ways of preserving them.

There are clearly sensible reasons for not importing live cattle of either sex onto the Island, in the event of lifting the ban; there is also an arguable case for not allowing the import of

frozen embryos. In the event that only frozen semen is to be permitted, it is important to realise that the improved efficiency resulting from using imported genetics will not show through immediately.

It is not possible to compare the Island Jerseys directly with the Jersey performance figures because the Island Jerseys do not participate in Interbull. However, it is still possible to measure the likely outcome of the use of imported genetics. These figures show that it would take approximately seven years for the additional initial investment in imported genetics to become cash positive overall for those farmers importing genetics, a summary of which is shown below for a 120 cow dairy herd⁴.

Figure I - Summary of the Financial Benefits of Importing Semen (£)



⁴ Environmental Management and Rural Economy Economic Development and Planning and Environment February 2006

As Figure 1 shows, the lifting of the semen ban would take several years before the dairy farmers wishing to use the imported semen would benefit financially as a result⁵. In addition, based on the farmer interviews, it is also unlikely that all the farmers on the Island would use imported semen in the event that it was allowed, at least initially. This would further delay the financial benefits resulting for the farmers on the Island as a whole.

The individual circumstances of the farmers using imported semen would dictate whether they chose to produce higher yields per cow, or to produce a similar yield from less inputs. If they chose to maintain cow numbers and produce higher milk yields, then they would clearly require additional milk production licence litres (these are accounted for in the assumptions within the analysis shown above), and hence would depend on other farmers being willing to trade them.

It should also be borne in mind that the import of semen would provide greater choice for the Island's dairy farmers with regards to selecting for milk quality, in line with potential future changes in terms of requirements (including somatic cell counts, as well as butterfat and protein). This is another instance where the milk pricing needs to send a strong signal to the dairy farmers on the Island as to the composition of the milk that they are producing.

A further issue arising from the import of semen is that it should enable dairy farmers to select bulls with type traits, which would also potentially bring financial advantage through greater longevity, for instance.

5.5 Product Mix

This is the last element of the dairy industry plan for Jersey - the key points to note are as follows:

- the core part of this piece of the strategy is to supply Jersey with Jersey produced local milk, currently 9ml pa. There may well be brand loyalty to Jersey milk, but that could be tested if the price differential is too great between local milk, and the potential of imported milk
- the danger is a repeat of the jigger pot disaster, where the JD tried to sustain a high price for this specialised milk market, ignored the customers interests too much, and so lost the entire market to another (Irish) supplier who put the customer first. Their objective

⁵ Based on a typical 120 herd operation

of reducing their wholesale price of milk, so that it could be retailed at around 70 – 72 ppl is entirely correct

- but it is also important to recognise that to maintain a given volume of wholesale milk supply to customers 365 days per year, there has to be a structural surplus of milk. This has to cover the peaks and troughs of ex-farm supply, of seasonally wet or dry or cold years for forage supply and milk production, and of product wastage. This suggests a minimum ex-farm production of 11.5 – 12 million litres per annum to satisfy the Jersey liquid and fresh product market
- the price aggressive liquid UK milk processors have removed their cost of disposal of this balancing milk by buying only 65% of their needs direct from farmers. They buy the rest from the milk co-operatives, who act as brokers, leaving the co-operatives with all of the secondary milk movement costs, and disposal of seasonal surplus at basement prices. This option is not available to the JD without importing liquid milk
- the consumer has (as in the UK) largely chosen to buy 1.5% fat content semi-skimmed milk, but the Jersey breed produces 5.2% fat milk on average. There is therefore an inevitable surplus of butterfat from any given sales volume of milk consumed, irrespective of cattle breed, but made worse for the Jersey breed
- SMP and butter are world traded low price commodity products. Jersey will never compete with the worlds' lowest cost, but high volume milk producers in New Zealand, Australia or Latin America, nor with the big volume processors on the cost of processing of these products
- EU butter prices have fallen consistently over recent years, from £2100 per tonne to £1700 per tonne now, and Jersey bulk butter has consistently earned £200 per tonne less than UK butter. Jersey SMP is of such poor quality (from the antique old drier) that it is only suitable for UK stock feed use, and earns £550 per tonne less than UK product

The strategy is therefore correct, to move away from commodity product that cannot compete with the UK on price, let alone the rest of the world.

However, it also that means that the JD must find a higher value market for these structural surplus products, in what is an aggressive international market place. The plan for the new dairy is for 14.5million litre capacity, which infers the need for a substantial market for products from 5 million litres of milk.

This is much easier said than done, of course, but it might be argued that one reasonable contract with a mainland retailer for say high quality yoghurts might be sufficient to account for

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this sort of volume of milk. However, there are lessons to be learnt from the jigger pots market experience which was lost in rapid fashion to the Irish dairy sector – not least having all eggs in one basket etc.

While highly encouraging progress has been achieved in recent months by the JD in developing a dialogue with major retailers on the mainland, this has yet to come to full commercial fruition. And it might take a further 12 – 24 months before any tangible success is really achieved.

The basic strategy is correct – but as often the case in these situations, the timing and implementation is proving to be more challenging.

6. PERFORMANCE OF THE DAIRY HERD

6.1 Financial

Jersey dairy farmers have a full farm costing service available (DICS), financed by the States and the JMMB, which allows a business performance comparison with each other. The chosen system uses “Earnings Before Tax, Interest, Depreciation, and Amortisation” or “EBITDA” as the measure of profitability. This is excellent for the detailed benchmarking purpose that it was intended for within Jersey, and produces very timely data. But it is curious in that while it **does** include leasing charges for purchasing machinery and capital items, but **does not** include depreciation or interest on borrowed money for those who buy, rather than lease equipment.

Promar International provides full farm management accounts (the FBA) for UK farmers, and select a subset of these who are specialist dairy farmers with minimal other farm enterprises. These provide full profit and loss accounts and balance sheet information, as well as technical analysis of all enterprise performance. In order to make the two data sets fully comparable, we have taken out the nominal “paper” expenses allowed for in the EBITDA calculation, actual rents and leasing costs, and the interest and depreciation charges shown in the FBA data.

We are now able to directly compare the “gross profit” before any resource costs for both Jersey and the UK specialist dairy farmers, and the direct overhead and variable costs, as shown in Table 4 below. Gross profit shows the farms management ability to efficiently produce milk, irrespective of how the farm is financed and resourced.

It should be pointed out that most of the farms in this FBA sample have black and white cows: there are just two Channel Island herds, which is about the normal UK herd breed make up. However, consumers buy milk, cheese, and other milk products irrespective of the breed of cow farmers use to provide the raw material.

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Table 4 - Comparison of DICS and FBA data

	FBA Data (2005-6)		DICS data (2005-6)	
	Average £/cow (120 farms)	Top 25% £/cow (30 farms)	Average £/cow (23 farms)	Top 25% £/cow (6 farms)
EBITDA as shown			179	596
Add back:				
Staff accommodation			86	70
Farmer and family labour			131	46
Management charge			100	100
Tenant land adjustment			-69	-95
			25	47
= Profit before all of the assumed costs	404	584	452	764
Plus actual leasing charges	2	2	65	33
Plus actual rent paid	68	86	138	99
= Profit before resource costs- rents, depreciation, interest, and leasing charges	474 (6.6ppl)	672 (8.5ppl)	655 (15.4ppl)	896 (19.8ppl)
Total direct production costs	15.3ppl	13.5ppl	27.2ppl	22.1ppl
Less direct overhead costs	599	595	580	532
Gross Margin	1,071	1,265	1,235	1,428
Less direct variable costs	507	450	578	472
= Gross Output	1,578	1,715	1,813	1,900
Milk value (£/cow)	1,386	1,509	1,441	1,495
Milk Output (ppl)	19.2	19.2	33.8	33.0
Subsidies	192	206	307	317
Other			65	89
Gross output (ppl)	21.9	21.8	42.6	42.0
Cow numbers	162.1	221.6	126	129
Milk yield per cow	7,203	7,854	4,258	4,529

This data clearly show the strengths and weaknesses of the average Jersey dairy farm:

- gross output is 20.7 ppl higher on average than the UK average
- direct subsidy income of 7.2 ppl is 4.5ppl greater than the UK average
- Jersey variable costs (feed, seed, fertiliser etc) are £71 per cow higher, though overhead costs (labour and machinery costs mainly) are very similar at just £19 per cow lower

- together, these total direct production costs are 11.9 ppl greater for Jersey dairy farms, when expressed per litre of milk produced
- profit before resource costs is therefore 9 ppl higher than the UK average, and this becomes 11.3 ppl for the top 25% of Jersey farms

The relevance of this large difference in milk production costs is that if Jersey retailers choose to import milk at some future date, and if they are able to in law, then it is from the UK that milk is likely to be sourced.

The simple data in Table 4 shows that total production costs are higher in Jersey than on the mainland by 11.9 pence per litre. Just where the differences lie is shown in Tables 5 and 6 below.

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Table 5 - Dairy Herd Gross Margin from FBA and Jersey DICS data, 2005-6

	FBA Data (2005-6)		DICS Data (2005-6)	
Physical details per cow	Average	Top 25%	Average	Top 25%
Herd size	162.1	221.6	126	129
Milk yield (litres)	7,203	7,854	4,258	4,529
Milk price (pence per litre)	19.3	19.2	33.9	33.0
Concentrate (kg)	2,435	2,600	1,790	1,630
Price (£/t)	129	128	203	198
Feed rate (kg/litre)	0.34	0.33	0.42	0.36
Gross Margin Detail (£ per cow)	£	£	£	£
Milk output	1,386	1,509	1,441	1,495
Total calves	48	53		
Total returns per cow	1,434	1,562	1,441	1,495
Concentrates	313	332	364	323
Roughages	22	14	0	0
Vet and Medicines	57	54	54	33
Office, milk recording costs	24	20	} 24	} 23
AI and Semen	28	30		
Herd Replacement Costs	72	58		
Bedding	18	16	9	3
Dairy chems, miscellaneous	46	45	36	27
Fertiliser, seed, spray costs	55	51	91	63
Total Variable Costs/Cow (pence per litre)	635 (8.8ppl)	620 (7.9ppl)	578 (13.6ppl)	472 (10.4ppl)
Gross Margin Per Cow (after forage costs)	799	942	863	1,023

The herd replacement charge for Jersey herds is not specifically calculated as in FBA, but the heifer rearing costs (of feed, forage, AI etc) are expressed within the variable costs of the dairy herd, so the net result is the same.

Table 6 - Overhead Cost Analysis

	FBA Data (2005-6)		DICS data (2005-6)	
	Average (pence per litre)	Top 25% (pence per litre)	Average (pence per litre)	Top 25% (pence per litre)
Farm size (hectares)	122	169	59	58
Annual milk output (litres)	1,167,606	1,740,446	536,508	584,241
Total wages	2.32	2.37	6.20	6.07
Machinery repairs	0.68	0.62	2.28	1.35
Fuel and electricity	1.09	0.92	1.53	0.91
Contract and hire	1.46	1.19	1.90	2.30
Vehicle tax and insurance	0.11	0.08	N/a	N/a
Total power and machinery	3.34	2.82	5.71	4.56
Farm and building insurance	0.39	0.29	In misc	In misc
Office	0.72	0.51	In misc	In misc
Miscellaneous	0.17	0.16	1.20	0.88
Total admin charges	1.29	0.96	1.20	0.88
Water	0.39	0.35	0.04	0.07
Property rates – local tax	0.20	0.14		
Farm, property repairs	0.97	0.93	0.47	0.15
Total property charges	1.56	1.44	0.51	0.22
Rent (long and short term)	0.82	0.92	3.20	2.19
Fixtures depreciation	0.59	0.46	N/a	N/a
Machinery depreciation	0.92	0.84	N/a	N/a
Equipment Leasing	0.11	0.07	1.5	0.68
HP and loan interest	0.24	0.25	N/a	N/a
Current bank interest	1.38	0.93	N/a	N/a
Total Resource Costs	4.12	3.69	N/a	N/a
Total Overhead Costs	12.62	11.27	N/a	N/a

The key points to note are as follows:

- the major difference shown in the gross margin costs (also known as the variable costs) is the total feed and forage cost of milk production. These two alone amount to 10.7 ppl for Jersey, and 5.1ppl on the mainland. The key reasons are:

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- the higher price of concentrate feed at £203 per tonne
- the higher usage of concentrate feed at 0.42 kg per litre of milk
- the price and usage of seeds and fertiliser for forage crops, though tonnage and cost per tonne cannot be split apart as for concentrate feed cost
- some of the concentrate feed cost difference is inevitable, with the shipping cost of bagged feed, and the difficulty of importing cheaper alternative feeds. However, some of the higher cost may be a manufacturers' reaction to higher milk price and money available, and some to the inclusion of expensive CI6 fat and other supplements
- the high usage of concentrate feed could be slightly lower, as shown by the top 25%, though this may be being hindered by the lower feed conversion efficiency of poorer genetic ability in the Island herd
- the higher concentrate usage will also be influenced by the lower grain content of later planted forage maize or corn crops after potatoes, resulting in bulk rather than high energy content, milk producing crops
- the overall stocking rate of Jersey animals is not really different to mainland Jersey stocking rate averages (shown in the dairy costing comparisons) so the much larger forage cost of the Island average is a function of the constant (and expensive) reseeding of crops and forages after early potatoes. Fertiliser price per tonne also reflects shipping costs
- there is a bigger range between the performance of the top 25% and the average in Jersey than on the mainland, suggesting that improvements can be made by many. This is particularly true of the concentrate feed use per litre, vet costs, and the forage costs per cow
- some of the overhead costs are known through the dairy industry costing, though not the full resource costs of interest charges and depreciation. The key differences shown are in:
 - higher wage costs
 - higher machinery and power running costs
 - rents
 - equipment leasing costs
 - rates (local property costs) on Jersey are significantly lower than UK
- the paid wage issue appears to be a function of business size: the average FBA herd has a wage bill of £27,065, but spread over 162 cows with 1.17 million litres of output. Similarly the top 25% have a £41,262 wage bill spread over 220 cows and 1.74 million litres of

output. The top 25% Jersey figures have a wage bill of £35,475 spread over an output of 0.58 million litres, hence more than double the wage cost per litre

- the power and machinery are higher in the areas of repairs, fuel and electricity, and contracting costs. We understand that the unit cost of electricity and fuel is possibly lower than on the mainland. So part of this high cost per litre of milk sold is again scale of operation, with the relatively fixed cost of running the farmhouse and farm vehicles spread over more litres with the mainland farm businesses
- the contracting charges per vergee for most field operations certainly seem higher than the UK, where there is considerable competition (and much of it from marginal part time operations “borrowing dads tractor” etc). However, it is the use of contractors rather than the cost per operation alone that drives this total cost
- in general the increased use of a farm contractor’s staff and machinery should reduce the farmers own wage, fuel, repair and depreciation charges in his business
- however, the Island infrastructure itself adds to the wage and machinery costs of producing milk on Jersey:
 - narrow and busy access lanes
 - small field sizes
 - the lack of piped water in those fields
 - the limited grazing area that the dairy cows can reach, so enforcing more mechanised storage feeding
 - repeated reseeded of secondary crops after early potato crops

All of the costs in a business can be changed to some extent. However, the fundamental issues of island infrastructure, rent competition for limited land, the limitations of the Island Jersey breed, and freight cost of imported goods will remain reasons for a higher cost of milk production on Jersey.

6.2 Technical

Having analysed the impact of the technical performance on the financial performance of the Jersey Island farms, it is also possible to compare more specific aspects of this performance to draw further lessons for the future.

The tables below show a comparison of the National Milk Records dairy herd performance and compare it to the performance of UK Jersey herds (see Table 7 -). They also review the DICS data converted into a dairy costings format, with the comparable UK figures for Channel Island herds (MDC and Promar) and Jersey only herds (Promar) in Table 8.

Table 7 - Comparison of NMR Dairy Herd Performance (2004-5)

Performance Aspect	UK Jersey Herds	Island of Jersey Herds
Milk yield per cow (kg lactation average)	5,381	4,689
Butterfat %	5.29	5.06
Protein %	3.79	3.80
Butterfat (kg per lactation)	284	235
Protein (kg per lactation)	204	176
Total fat and protein (kg yield per lactation)	488	411
Somatic cell count	180	199

Table 8 - Review of Available Dairy Costing Information⁶

Factor	MDC Channel Island	Promar Channel Island	Promar Jersey Breed	DICS Jersey Island
Herd Size	124	243	195	126
Stocking Rate (cows/ha)	2.56	2.82	2.82	2.81
Milk Price (ppl)	21.8	23.2	22.89	33.9
Milk Yield (litres sold/cow/year)	5,466	5,694	5,114	4,258
Feed use (kg/litre)	0.35	0.43	0.38	0.42
Feed use (tonnes/cow)	1.9	2.44	1.92	1.79
Feed Price (£/t)	137	119	129	203
Feed costs (ppl)	5.21	5.34	4.87	8.53
Milk yield from forage (litres/cow/year)	1,789	1,032	1,585	834
Margin over purchased feed costs (£/cow)	907	1,017	919	1,077

6.3 Conclusions

These are:

- in the UK, milk recording is entirely voluntary, costs around £12 – 15 per cow per annum, and only around half UK herds choose to use it. It is a self-selected group, and not a UK all herd average
- in Jersey, all cows in all herds are recorded and is subsidised by the State. As such, the Jersey data will include some herds that in the commercial UK situation may well choose not to milk record their dairy cows
- from the NMR data, it would appear that the Island Jerseys have a lower yield of 692 kg less, with poorer milk constituents, and 15% less total milk solids per lactation

⁶ As of 31 March 2006

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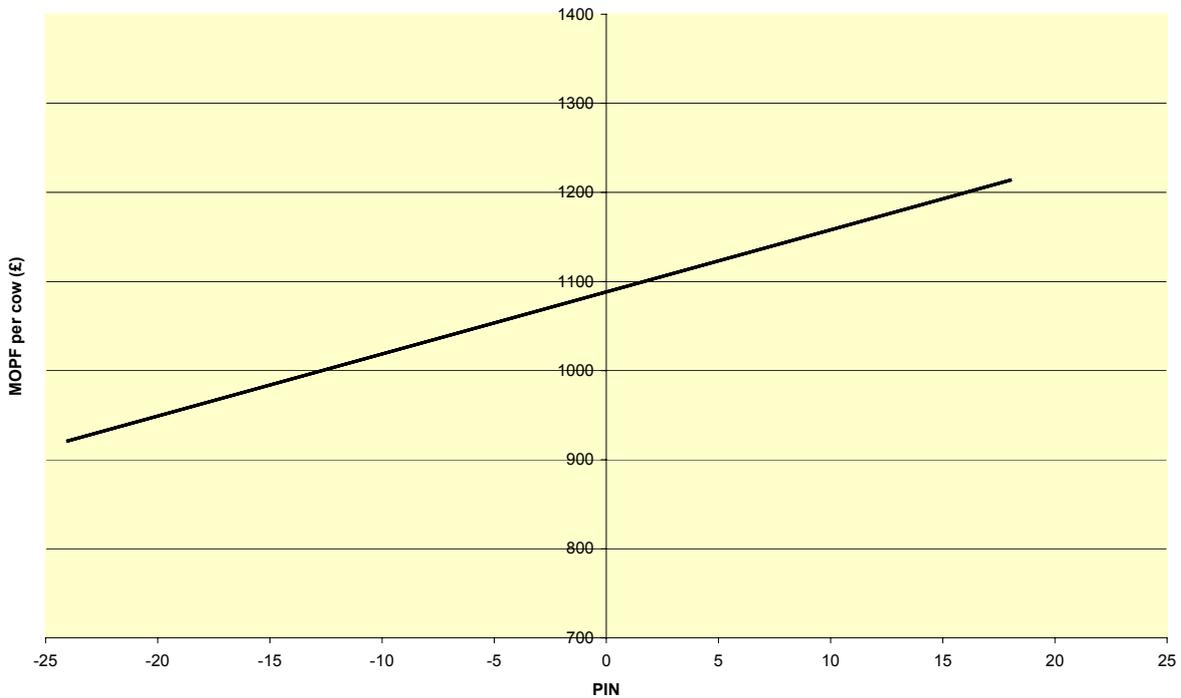
- from the DICS information, the Island Jerseys have a lower yield of 856 less litres than Promar costed UK Jersey herds. The limited herd numbers shown by the MDC averages put Jersey and Guernsey breeds together
- the CEDAR research farm based at the University of Reading has some Island cows and mainland cows on trial. The Island Jerseys are 400kg live weight compared to 450kg LW for the mainland cows. Although the Island cows give less milk in this trial, there was no difference on milk versus feed efficiency per kg body weight
- feed usage per litre of milk is higher on Jersey, but the DICS data does include a small element of concentrates fed to the dairy heifers being reared
- the amount of milk produced from forage is lower on Jersey than in UK, although the corrected stocking rate appears to be very similar. The DICS quoted stocking rate is 2.6 verges per cow, which equates to 2.16 cows per hectare. But, this includes the land used by heifer replacements, so the inferred stocking rate is $2.16 \times 1.30 = 2.81$ to allow for a 25% island herd replacement rate with heifers at 2.25 years old
- feed cost per tonne is substantially higher on Jersey than the UK
- milk price is substantially higher on Jersey than in the UK
- margin over bought feed costs is higher in Jersey by £158 per cow, or 17%, and this reflects the higher milk price rather than any efficiency measures shown in breeding or management

6.4 Dairy Performance In Relation To Genetics

It is possible to make an assessment of whether the use of better genetics leads to improved cow performance on the Island at the moment. In order to preserve anonymity the analysis shown below does not show the underlying data. However, the trend line resulting from the analysis shows a clear relationship between genetic merit, in this case expressed as PIN, and performance, in this case expressed as Margin over Purchased Feed (MOPF per cow) for the herds on the Island where data is available. It should be noted that, unlike the convention in the UK, the MOPF within DICS excludes feed used by youngstock.

This analysis, albeit based on a small sample, does show a clear relationship between the genetic merit of the herds on the Island and their performance. Part of the reason might be accounted for by the fact that the facilities and/or management of the higher genetic merit herds are also superior. However, this is unlikely to account for other than part of the trend shown in the graph above. This trend is consistent with previous studies conducted in the UK using much larger populations of farmers.

Figure 2 - Analysis of MOPF per cow versus PIN- Jersey Island Herds



7. THE IMPACT OF LIQUID MILK IMPORTS

7.1 Background

This is a highly emotive issue on Jersey and has been for some time – and as such it needs to be handled with a degree of sensitivity. There are both plus and minus points regarding the situation which impact on the future structure of the industry and the desire that government has to see “brown cows in green fields”. These are set out below.

However, despite the emotion surrounding the subject, the potential impacts of the import of liquid milk on to the Island are, in our opinion quite clear. What is also very clear is that in its current state, the Jersey dairy sector is in no real position to defend itself from severe competition, if it were that imports of liquid milk could not be resisted.

Again, this only serves to underpin the rationale that the Jersey dairy sector needs to take good advantage of any time it might have – and it does – to re-organise its own industry.

As a summary, our view – would be as follows:

- the current situation has protected the industry – but is not likely to be sustainable in the future
- if anybody wanted to bring milk in – it is unlikely that a legal challenge could be maintained if taken to the EU – and it should not be assumed that this is not going to happen
- if liquid milk came in, it would be at much lower price than is currently supplied
- a major retailer coming on to the Island might well respect the importance of the local industry and not source from off shore to begin with – but in the mid to long term, they are unlikely to tolerate what they see as an inefficient dairy sector. Other retailers would certainly follow suit
- there is support for the industry from key retail customers on the Island, but only to a limit - if someone bought milk in cheaper, they would be forced to respond
- consumer loyalty will only go so far – not least with a high proportion of the current population coming from outside the Island now

- the farming sector would be put under severe pressure
- it is inconceivable that some farmers would not be forced out of production
- the dairy itself would lose a considerable amount of market share - as much as half over a period of time
- the industry would go into free fall - in its current state
- Government objectives of “*brown cows in green fields*” would be thrown into turmoil

To head this potentially disastrous situation off – the dairy sector needs to take advantage of the time it might have to get itself in shape – lower costs of milk production – get the factory efficient and shore up customer support

The more detailed “for” and “against” arguments are as follows:

7.2 Pros

These can be set out as being:

- Jersey currently consumes c. 9 million litres of liquid milk, and this would be a marginal volume for one of the UK’s leading milk processors with spare capacity to supply

Case Study - Wisemans

Wisemans are currently building a liquid milk bottling plant at Bridgwater, Somerset, with 350 million litre capacity. This plant will buy 65% of its needs direct from farm, and contract to buy 35% from the co-operative milk brokers, who then have all of the secondary costs of dealing with seasonal over or under supply.

There are no other products, no milk product sold at below cost, and surplus cream from the semi-skimmed milk demand is simply sold off. This plant will distribute milk across the South and South West of England.

It plans to employ 350 – 400 people for the entire farm collection, processing, and distribution of that volume. Jersey’s entire liquid market is just one 25 tonne lorry a day from there to put on a ferry

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- this combination of buying ex-farm cheaply at 19 ppl with this high level of processing efficiency can provide the consumer with the cheapest milk on the shelf (subject to the retailers margin) albeit primarily from black and white cows. This milk could be on a Jersey shop shelf at possibly around 65 ppl
- this route would also provide consumers with a larger range of milk bottle sizes than the JD from 0.5 pint up to the one litre, 4 pint, onto the 6 pint fridge door size. This would also use a range of modern plastic screw topped bottles, that are blow moulded on site as part of the milk bottling line, rather than using a wax carton⁷

7.3 Cons

These can be set out as being:

- if one retailer introduced much cheaper milk for sale, the others would have to follow for such a base household consumer necessity, and Jersey would very quickly have a small “milk price war”. There would be very little time for the local Jersey dairy industry to adjust
- Jersey’s higher milk price to farmers supplying the raw material at 33 ppl, combined with the higher cost processing of multiple products at the JD could not compete at this price
- as a consequence, Jerseys farmers and the JD would lose a large part of their market for more profitable liquid milk sales, and would have to fall back on the less profitable dairy product market, that they are not currently well equipped to supply. And this market is already saturated by large volume and international specialised suppliers
- the dairy farmers would see a fairly immediate price crash: there is insufficient equity left in JD to keep the milk price up by bank borrowing as happened after the crash of the Jersey dairy jigger pot market
- Jersey would therefore also have to import more of all other dairy products. It is conceivable that this could cause a problem for daily supplies delivered by sea, in a particularly bad winter storm – but to be fair, this, based on feedback gained in the project, is unlikely to happen on a regular basis

⁷ It might be difficult for the JMMB and/or the JD to carry out this sort of operation on the Island even if they wanted to on the grounds of environmental constraints

- there would be openings created for entrepreneur Jersey dairy farmers to supply smaller volume mainstream and niche dairy products to market. However, there would be little ability for any larger dairy to buy any milk that they produce, but eventually proves surplus to product sales and requirement
- the Jersey dairy herd numbers would fall to whatever market size Jersey milk could retain, perhaps 20 – 30% of the current 9 million litres – and which would need only as few as 500 – 600 dairy cows on the Island to produce
- this smaller Jersey cow population would be too small a genetic pool to prevent in-breeding and be sustainable. Jersey would have to import Jersey semen to maintain the breed. However, importing Jersey semen will mean importing semen from other breeds as well, so in time the fields may have Jersey crossbred beef rather than dairy cows. So why not import these as pure breeds and at least have an efficient beef breed?
- neither of these outcomes achieves the objective of maintaining the iconic breed of Jersey cows farmed in the small green grass fields of the Island
- the solution to this could be a Jersey herd kept on a farm museum basis for tourists – “*this is how it used to be*” – but is that desirable?
- there would be less farmer competition for land, so farmland rents will fall, and so allowing more land for Jersey Royal potatoes. However, potatoes already utilise around 50% of the available cropped land area, and further growth in cropping would change the balance between fertility building crops like grassland with stock, and fertility taking crops like potatoes. There would be a number of wide ranging environmental issues to address, for Jerseys’ flora, fauna, and soils
- the secondary industries based around stock farming would become unsustainable, or dramatically smaller. For example the feed, seed, fertiliser and supply services, the veterinary services, the cattle breeding and AI business, and there should be very little need for an abattoir. The JD as it now is would probably not exist. There are very many Jersey people in this whole chain whom would no longer have employment as a result of importing milk and milk products
- there would be a different waste disposal problem for Jersey States with the bulky plastic milk bottles to deal with instead of the crushable wax cartons

8. OPTIMUM MILK PRODUCTION LEVELS

8.1 Introduction

Identifying or defining an optimal level of production for an essentially closed agricultural system such as the Jersey dairy industry is not a straightforward task. Defining an optimum level of production is essentially about identifying a level where supply and demand for Jersey dairy's products are in balance. Milk production's seasonal nature, combined with changes in consumer preferences and demand as well as fluctuating product prices mean that supply and demand levels for dairy products will vary over time. This means identification of a single optimum production level may be something of an academic exercise.

Understanding the supply and demand situation is essential for any dairy company. It is even more important though that companies are able to respond to these changes effectively and rapidly to ensure that supply closely fits market demand and that the company and industry maximise profitability. The supply and demand situation for the Jersey dairy industry has been evaluated based on three major areas:

- milk production or supply
- dairy product demand
- returns from different products

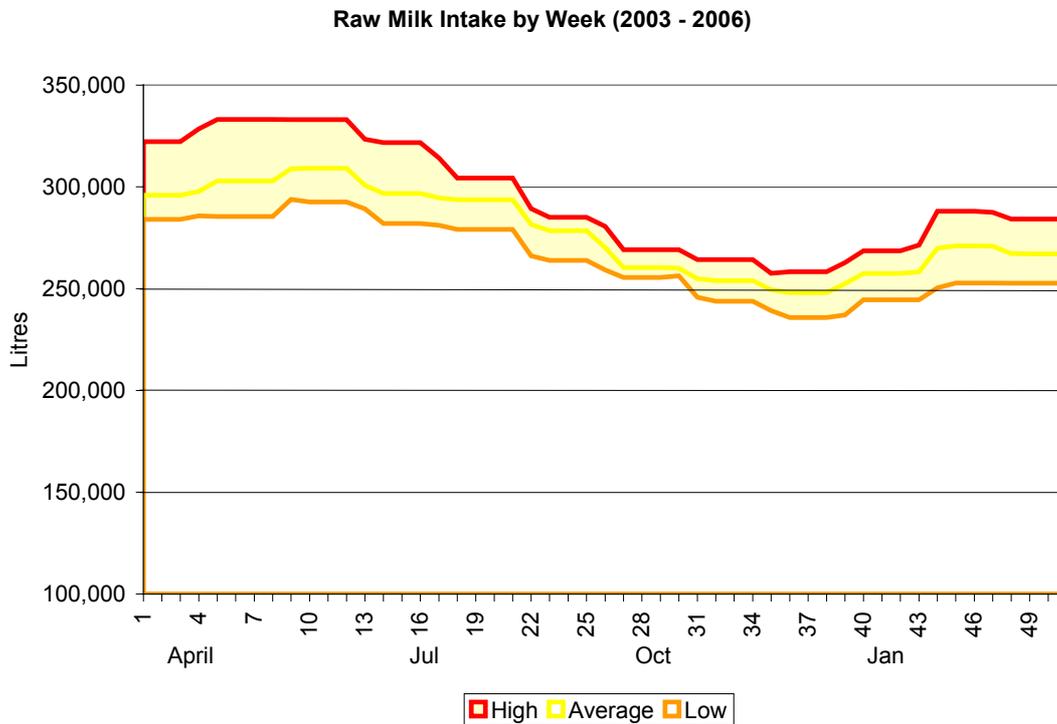
The following section explains these concepts in more detail. It also provides comment on the Jersey dairy industry's current supply and demand position.

8.2 Milk Production

Despite the technical advances in milk production over the last 50 years, milk remains a natural product, produced under system that is subject to variation. At the most basic level, this variation is expressed in the natural changing composition of the milk itself during the year. Unless cows are managed in highly intensive "factory like" farms, the volume of milk will also vary depending on the stage of lactation of the cows and the quality and volume of feed available.

An optimum production level needs to take into account these seasonal variations to produce enough raw milk to cover demand at all times. Figure 3 shows the natural variation in milk production in Jersey over the last 4 years.

Figure 3 - Jersey Dairy Raw Milk Supply

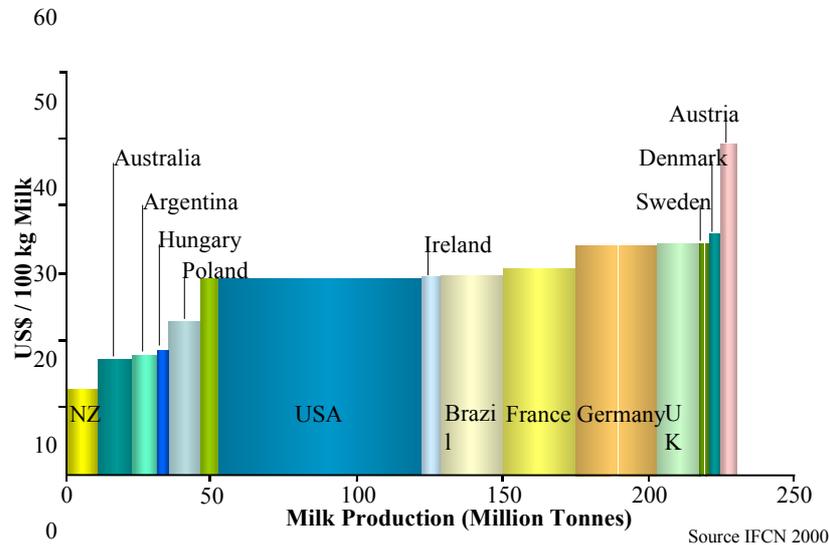


The milk intake data indicates that the industry has a monthly peak to trough ratio of between 1.2 : 1 and 1.35 : 1. This compares relatively well with the UK and extremely well with countries like Ireland. Although these peak to trough ratios are relatively low, they still mean that at times of peak production (between May and June in particular) the Jersey dairy industry would be producing upto 35% more milk than was required.

This situation is not unique to Jersey, and is a situation faced by dairy companies all over the world. To minimise this cost, most dairy companies use a range of tools and incentives to try and minimise production of “buffer milk” by better matching their milk intake curves with the milk demand curves. In the past, the main method for dairy companies was to produce enough milk to cover the base level of demand for fresh dairy products, such milk and yoghurt. They would then convert any milk produced above that level into longer life products such as cheese and SMP.

While this policy works well in theory, in practice the markets for products such as SMP, cheese and butter are becoming increasingly competitive and the profitability from these products is decreasing. In effect they are classic commodity products. In the future, it is expected that international producers such as Argentina and the Ukraine will be increasingly be important as key players in these markets. This is not least based on their low cost of production, along with other traditional suppliers such as New Zealand and Australia.

Figure 4 - the Global Dairy Cost Curve



The UK is not well placed to compete in the international market – and has historically been at the wrong end of the cost curve – Jersey is in the same situation. Figure 4 shows more detail of how various countries are positioned in this respect. The further to the left one is, the more competitive you are deemed to be.

This decrease in profitability is forcing companies – and the JD is no exception here - to either:

- **specialise in certain products** - like liquid milks, cheese, fresh dairy or commodities to gain economies of scale and efficiency. These specialised dairy companies then use a variety of trading arrangements to either sell their surplus milk in times of excess, or outsource part of their milk requirements by buying in top-up volumes of milk when required

...and/or.....

- **develop differential pricing for milk at various times of the years** - these prices need to be closely linked to the (real) market value of milk during different times of the year. When used effectively, these policies “flatten” milk intake curves and better match supply with demand

In reality, most dairy companies use a combination of both methods to minimise buffer milk production and match supply and demand as closely as possible. While specialisation and outsourcing of milk supply provide best-practice examples, they are not tools that the Jersey industry can easily use at the moment.

This is not least due to the historical development of the sector (i.e. no imports of liquid milk and the role of the JMMB as essentially a farmer facing organisation). The current import licensing system used on Jersey means that the JD is unable to either buy-in raw milk when required or sell (export) raw milk in times of surplus. Jersey's relatively isolated position along with high transport costs means that even without the current import licensing system, transporting volumes of milk to and from Jersey may not be economically feasible.

The only option open to the JD to modify its current milk intake pattern is via strong seasonal price signals to farmers that reflect the real value of milk to the factory (and ultimately, the farmer, in terms of product return). As we have said in Section 4 of this report, the price signals given to farmers by the JMMB are weak. Making changes to milk intake through demand price signalling is a difficult – but not impossible - task. In most situations, it requires extensive consultation and communication with farmers to implement. In the initial stages of use, relatively long implementation periods tend to be required. This is to allow farmers to change their businesses in response to the new price signals.

The impact of the above factors means that in the short term, the JD is likely to maintain its seasonal milk supply and therefore a requirement to convert seasonal buffer milk into long life products such as milk powders, butter or cheese etc.

8.3 Dairy Product Demand

As well as variation in production of raw milk, all dairy companies have to cope with variation in customer demand for the final product. However, this may not be a large issue on Jersey. Jersey's small population and the staple nature of most dairy products, means that milk and dairy product consumption on Jersey appears to be relatively stable –as it is in the mainland UK market. According to retail interviews carried out in this study, milk demand varies little from day to day. The only time milk demand really changes is when there are public holidays.

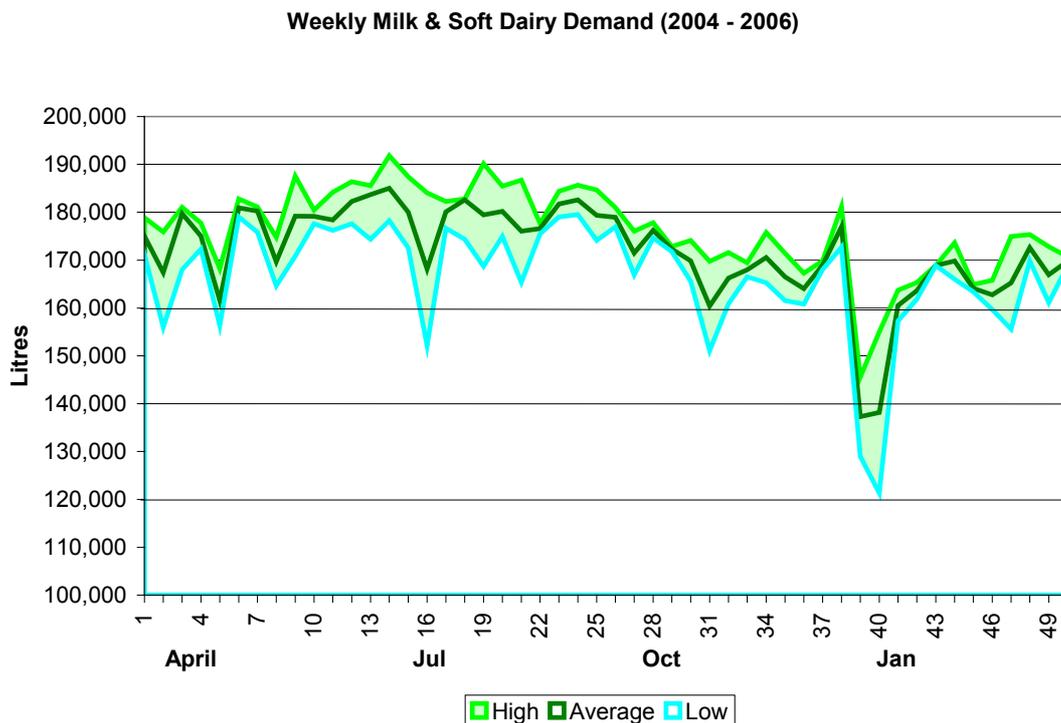
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Liquid milk dominates Jersey Dairy's consumer products business and accounts for around 63% of whole milk intake. In contrast "soft" dairy products⁸ such as yoghurt, butter, cream fraiche and cream only account for 5.2% of whole milk intake.

Figure 5 below shows the average weekly consumer demand for liquid milk and soft dairy products over the last 2 years in Jersey.

Figure 5 - Jersey Liquid Milk and Soft Dairy Demand



Although the variation in demand for dairy products may not be particularly great on a week to week day basis, as the sole supplier of fresh liquid milk on Jersey, the costs of not having sufficient stock to meet demand are particularly high. The need to satisfy liquid milk demand at all times, means that the JD has to run a larger than average buffer to ensure that there is always sufficient milk to cover possible variations in demand.

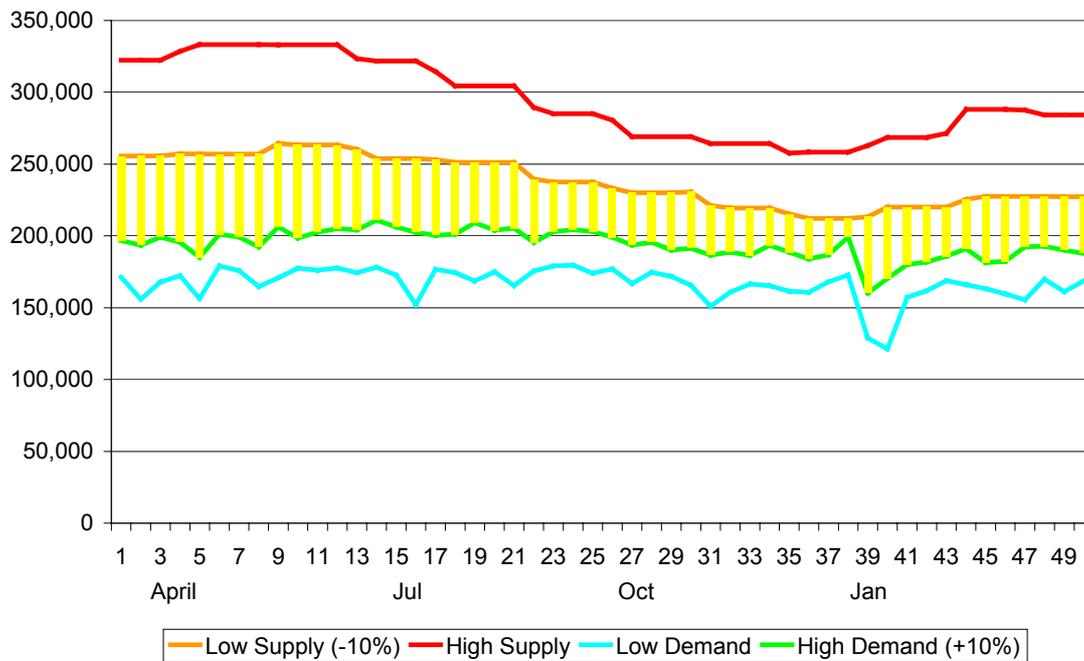
⁸ For the purposes of this report Promar uses the term "soft dairy" to define non-liquid consumer packed milk products such as butter, yoghurt, cream, cream fraiche and ice cream etc.

8.4 Matching Supply and Demand

An identification of the supply and demand situation at the JD can be made by matching the supply and demand curves together. To fully account for variation in supply, we have taken the lowest weekly milk intake levels recorded over the last 4 years and then subtracted 10% from these low figures to create a worst case supply scenario. To allow for any variation in demand, we have taken the highest weekly level of demand recorded over the last 3 years and then added 10% to these figures to create a best case (i.e. the most sales) demand scenario.

Figure 6 - Jersey Dairy Supply and Demand

Worst Case: Jersey Dairy Supply & Demand



Combining the supply and demand curves for Jersey Dairy along with our “worst case” buffer levels clearly indicates that at all times of the year there is a significant gap between demand for liquid / soft dairy products and raw milk intake (as shown by the bars in the chart). This gap can be described as “excess” milk, but the real issue is, in our view, largely dependent on the returns that can be made from this excess milk.

8.5 Milk Returns

The dairy industry is essentially a refining business, taking in a single raw material and producing a range of products from the various fractions of the original input. The demand

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for the different final products and the prices paid for these products varies considerably (both at a single instant and over time). There is a wide range of gross profit⁹ levels made on the core product lines currently produced at the JD. Premium yoghurt is the most profitable item while SMP is the least profitable and actually makes a loss.

We have assumed that as the commercial arm of the JMMB and while looking to get the best return for the milk fund over the long term, that the JD is also looking to maximise its overall profit. In this situation, it is likely that the factory would allocate milk intake to the most profitable lines first, and continue to allocate milk to make products that achieve a positive gross profit margin.

In an ideal world, 100% of the JD's raw material intake would be allocated into product lines that provide a positive return. Under current conditions, these products would include cream, yoghurt, liquid milks, ice cream and retail packed butter. However, analysis of the JD production data indicates that raw milk volumes (up to 25% of total intake) are being allocated to products such as SMP and bulk butter that currently provide a negative gross margin.

⁹ Figures are based on Jersey Dairy 2006/07 standard costs, excluding depreciation.

Figure 7 - Skim Milk Usage by Product Type and Profitability

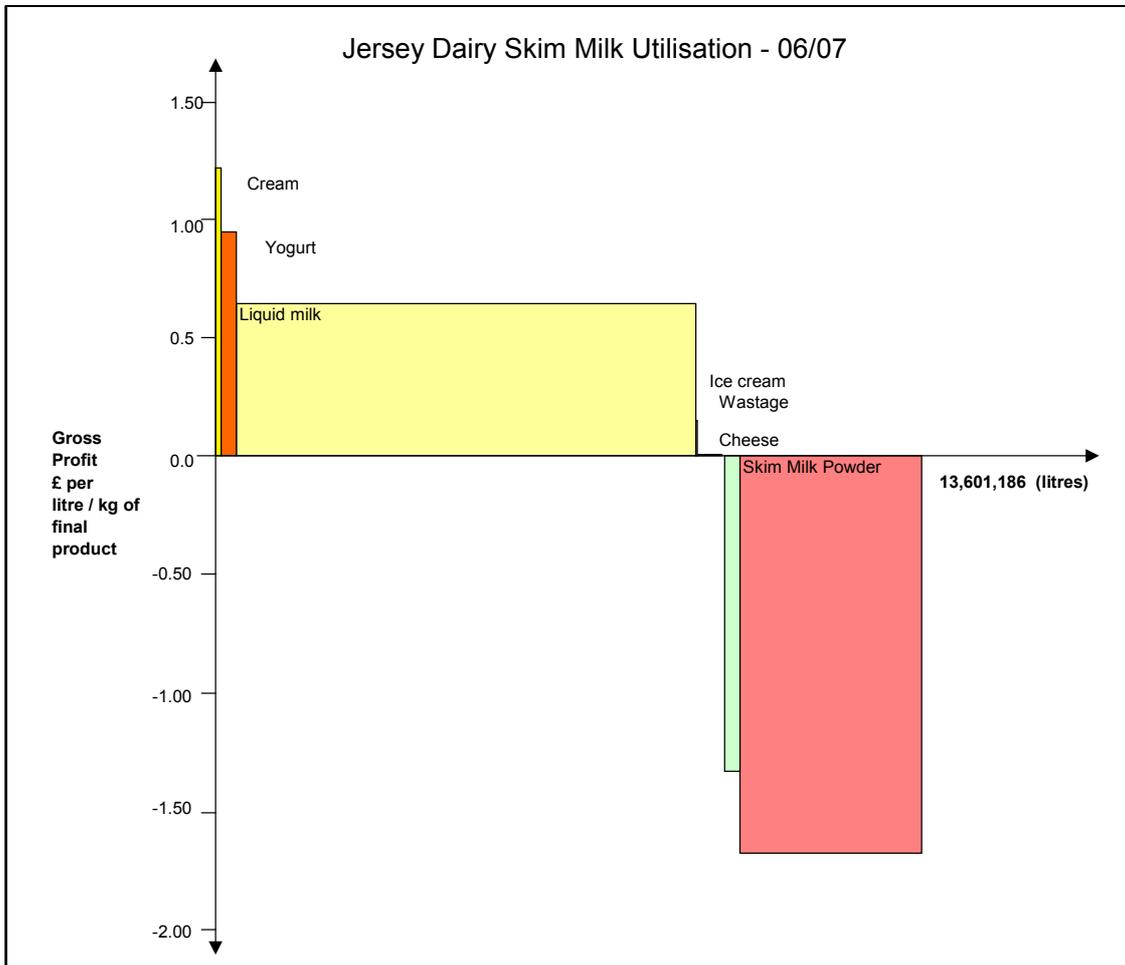
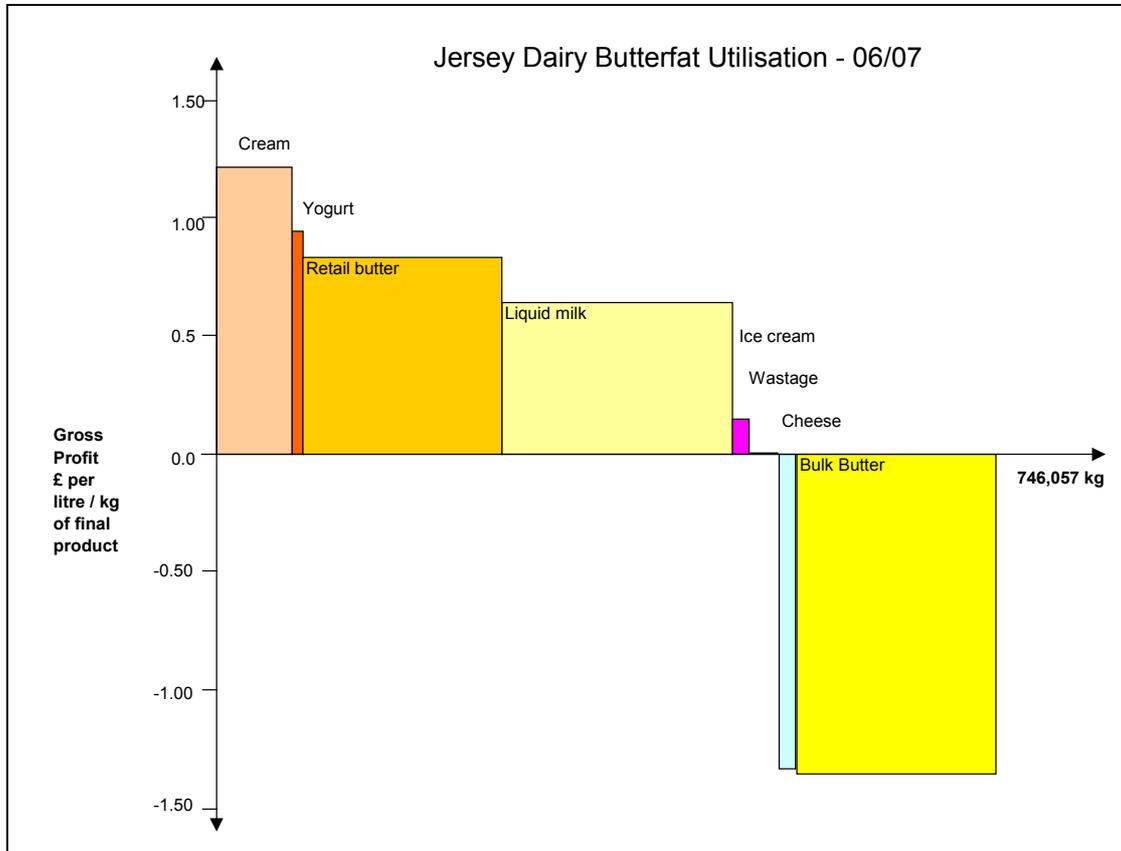


Figure 8 - Butterfat Usage by Product Type and Profitability



The current profitability of the dairy factory and the various product lines is well known by the senior JD management team. Unlike 3 years ago, when the McQueen report was first published, the current JD management has a much more detailed understanding of the costs and margins for the range of products produced at the factory.

Rather than seeking to reduce the level of overall milk intake, JD management is working on implementing strategies that will shift the current excess milk into products that provide a positive contribution to the profitability of the business.

Current initiatives include:

- developing export markets for high value products, such as yoghurt
- identifying higher value export market niches for products such as Jersey bulk butter
- improving the quality (and therefore price) of both bulk butter and SMP
- developing more profitable products and processing capacity such as cheese, to handle the current surplus milk volumes

Given the current levels of excess milk, in most situations, the logical step would be to reduce milk intake immediately and then slowly rebuild milk volumes as the various initiatives listed above took affect. However, the closed nature of the Jersey dairy industry (particularly, the lack of milk-flow, and breeding stock in and out of the system) means that responses and strategies which work in the UK or elsewhere may not work on Jersey.

A rapid decrease in the Jersey herd size now may alleviate short term costly processing of excess milk. However, with live animal imports banned, the only way the Jersey industry can increase its milk production levels significantly in the future is through breeding increased heifer replacements. Assuming the demand for milk increased today, it would take upto 3 - 4 years before a new cow could be in a herd and producing that milk.

The ageing nature of many of Jersey's dairy farmers also means that a number of farmers will cease farming in the next few years anyway. If this milk quota is not reallocated, the JD milk intake is likely to decrease naturally over the next few years, so reducing the current levels of excess milk.

For the last 3 years, the dairy industry on Jersey has been in a very fragile state regarding farmer confidence. Making a third attempt at addressing industry profitability by reducing herd numbers may be seen by many as a sign – not least from a physiological perspective as “the beginning of the end for the industry”. The magnitude of losses from the excess milk and the implications of making radical changes to the level of milk intake mean there are no easy answers for the Jersey dairy industry.

Given the above factors, the challenge for the JD is to fully implement the remaining elements of its dairy industry recovery plan - as quickly as possible. There are two key areas for this to focus on as top priorities from a marketing perspective:

- **firstly** - securing a new and vastly more efficient factory site. The JD business then needs to convert the surplus milk that is currently being accepted by the factory into products

that provide a positive return to the company. This is not going to be easily achieved, but at the current site at Five Oaks is going to be all but impossible

- **secondly** - the dairy needs to better manage the inevitable volumes of buffer milk that will be required to meet seasonal and consumer demand fluctuations

This includes:

- having the ability to efficiently manufacture products that will generate the greatest market return from the milk
- minimising excess buffer milk production by implementing aggressive price signalling systems back to producers that will accurately reflecting the market value of seasonal milk to the JD

8.6 Summary

The JD is currently accepting more raw milk than is required to meet demand for the products that provide a positive return to the business. While this excess milk could be reduced through a quota buy back programme, the costs associated with this move are high and could result in a collapse in the industry. The JD is well aware of this situation and is in the process of implementing strategies that will reduce the total excess milk level. The JD is also in the process of developing products and production capability that will allow it to efficiently handle volumes of milk that are required as a buffer against the natural variations that occur in both supply and demand for their core dairy products.

Developing new markets and products is a not a simple task and requires time. However, the current levels of milk intake are above optimum market levels and the JD needs to find profitable markets for this milk as soon as possible. The JD needs to set targets for development of these markets and to allocate sufficient resources to ensure the targets are met. If these cannot be achieved, then the JD needs to look at implementing systems that will reduce the overall milk intake to closer match supply with demand.

Cutting supply to the factory in the short term could be achieved – not least if just a small number of farmers opted to run their business outside the auspices of the JMMB, this might see a fall of intake (depending on who it was) of between 0.5 – 1.0 million litres. The temptation to reduce capacity in the very short term should be resisted. A good argument might be made for it – we have indicated above that the JD currently accepts more raw milk than it needs – but once this is cut, it might take up to 3 years to bring it back. Once it is gone, it is gone.

This at the very time that the JD is actively pursuing new business on the mainland market, and on which the future of the JD business is heavily dependent. There is limited growth in the domestic market and the threat of imported liquid milk is never going to be far away. If a contract of any size was won with a leading UK mainland retailer, it would be counter productive, at the very time that JD might need all the raw milk it can get, to make a once and for all cut to production.

It might be achieved anyway by a small number of farmers choosing to operate outside the realm of the JMMB and/or exiting the industry altogether.

If after a period of time, it becomes obvious that the idea of exporting to the mainland UK market is not going to be achieved – then a much harder decision has to be made. This also has implications for the size of any new processing facility that might be required on Jersey too.

9. EXPORT MARKETS

9.1 Introduction

One of the key components of the industry's recovery road map is the development of export markets. Given the limited growth opportunities on Jersey, the only way to build a dairy industry that can provide economies of scale and future growth opportunities is through developing export markets. While building an export capability is the simple answer to the Jersey industry's problems, the actual development of export markets is any thing but simple.

The following section of the report highlights many of the challenges that the JD faces in developing export markets and identifies a few of the areas where the JD may be able to create a sustainable market position. Although dairy products are mainly consumed in the country of production, the international market for dairy products is well established and can be divided in to two basic categories.

9.2 Ingredients

Dairy ingredients represent the vast majority of products traded on an international basis and include concentrated milk products such as SMP and whey powders, as well as cream etc. Most ingredients are manufactured to meet to well-established international standards or specifications and are sold in bulk volumes for use in food manufacturing. Ingredients can generally be divided into commodity and value-added products.

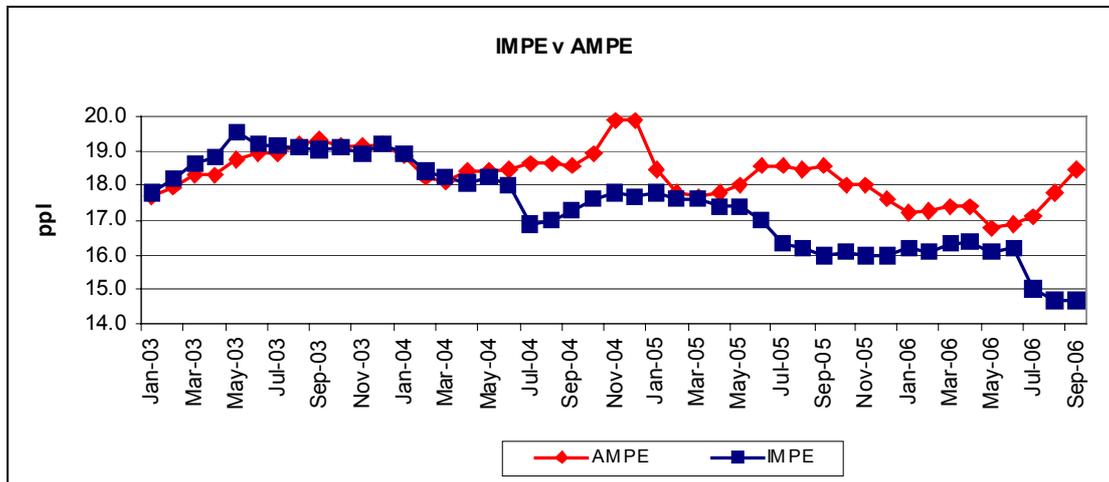
- **Commodity**

Commodity dairy products tend to be standard specifications of common products such as – skim milk, whole milk or whey powder, butter, cream or common cheese varieties. Production of commodity dairy products is dominated by low cost dairy producers such as Australia, Argentina, New Zealand and Poland etc, with additional volumes from large dairy producers such as the US and from within the EU. The market for commodity dairy products is extremely competitive and largely driven by supply and demand. Given the low cost basis and cyclical nature of these markets, it is highly unlikely that the Jersey dairy sector could profitably compete in this arena.

Figure 10 below highlights the low cost base required for profitable manufacture of commodity products by showing the actual milk price equivalent (AMPE), or return per litre of milk, from production of SMP and butter at prevailing European prices.

For the last 3 years the AMPE has consistently been below 20 ppl and certainly well below the 25 ppl quoted by the JD as the price paid to Jersey farmers for their milk.

Figure 9 – Cost Base For Commodity Dairy Products



• **Value Added**

The high levels of price competition in the ingredients sector is encouraging many commodity dairy product manufacturers to look to add value or differentiate their products in order to gain a better price. Increasingly, dairy manufacturers are looking to develop high-tech dairy ingredients for food companies that will display particular functional properties required in the final food product. Development of these products typically requires large amounts of R & D and relatively long development time frames, as well as a detailed understanding of food manufacturing and customer needs.

While these high-tech dairy ingredients tend to achieve higher sales prices, the technical development and servicing requirements of this segment are likely to be beyond the current capabilities of the JD. In addition to high-tech value added ingredients, growing markets for provenance and speciality food may also provide opportunities for more traditional ingredients such as butter and cream. While these markets are strongest in the UK and Europe opportunities may exist in other countries such as the US.

The challenges to developing these market segments would include:

- identifying markets where the Jersey image is a sufficiently attractive proposition (the experience of the Jersey Royal Potato marketing group is that outside of the UK there is very limited awareness, let alone interest or preference for products from Jersey)

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- identifying the food manufacturers in those markets that are willing to pay a premium for a speciality ingredient, such as Jersey butter
- gaining a sufficient premium above the typical commodity price to make the products profitable for the JD to produce

To develop the speciality ingredients market segments Jersey dairy would need to access expertise in food manufacturing and ingredient sales and marketing. From what we have seen of the JD operation, we do not feel that these competencies exist in house at the moment – and they would either need to be bought in to the company and/or out sourced.

9.3 Consumer Products

While ingredient markets are globally recognised as being highly competitive, the same could also be said of European and UK markets for consumer products. Competition amongst retailers and development of supermarket brands over the last 10 years has created massive competition for food manufacturers and squeezed margins to the minimum. Despite the challenges, development of consumer preference for products through development of strong brands remains a key method for food producers to gain an increased share of the final value of their product.

Fragmenting consumer demands have created many opportunities for manufacturers of products that meet specific criteria – free from, organics, fair trade and provenance etc are just some of the market niches that provide opportunities for manufacturers to differentiate their products and target particular customer requirements.

The JD's successful consumer business in Jersey provides a good test market and platform for expansion into retail markets outside Jersey. However, there a number of challenges that the JD face in developing a retail presence in UK mainland and/or other international markets.

9.4 Challenges for JD Export Marketing

- **Island Isolation**

Clearly, being separated by sea from a customer market is not the best option for any perishable food manufacturer. As an example, feedback gained from interviews with Jersey based supermarkets suggested that there was no comparison between the JD, which was able to provide top up deliveries within a few hours notice, and a UK based food manufacturer that had a 3 day lead time to get a product on the shelf. To overcome the reverse comparison by international retailers, the JD would have to develop service capacity in the

market and hold sufficient inventories to be able to provide a competitive service to any retail customers. In the UK fresh dairy market, it is not uncommon for retailers to require delivery to any distribution centre or warehouse within 24 – 48 hours maximum. While this is not insurmountable, it would add additional costs to the product.

- **Transport**

In exporting dairy products to any market, the JD would face additional transport costs that were not faced by other manufacturers of similar products. These costs would be incurred on ingredients and packaging coming into Jersey, as well as product leaving the Island. Unless sufficient volumes are developed to create economic shipping (i.e. full container loads) the costs of moving products to any international market could be prohibitive.

The availability of transport options also limits the number and range of markets that the JD operation can export to. A daily shipping service would be a minimum requirement to successfully service an export market with short shelf life products, such as yoghurt and cream etc. With present shipping services, this requirement would effectively limit exports to the UK.

- **Established Markets**

In most, if not all of the major European retail markets, dairy products are well-established and mature category. In all sectors of the market, there are existing products with well-defined propositions. Unless the JD is able to develop totally unique products, it will be competing for shelf space in an existing category with often long established competition and at existing clearly defined price points.

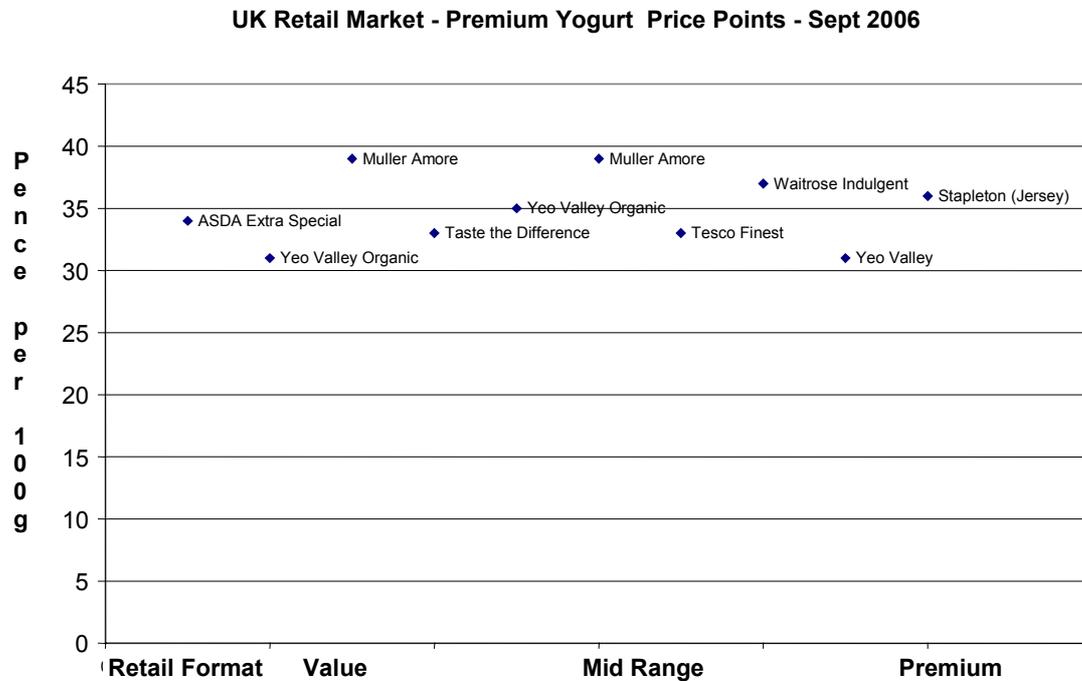
We fully recognise that the “*Jersey from Jersey*” marketing message is potentially an attractive and unique proposition. However, we do not believe that it is sufficiently unique or valuable to command a significant price premium in the market over and above that gained from other premium brands. There are already a plethora of Channel Island dairy products available in the UK market, sourced from the 400 or so Channel Island based herds on the mainland.

- **Pricing**

Even if the JD products are able to enter the UK and/or other international markets, it is likely they will be sold at similar price points as other (locally) made premium products. The challenge for the JD is then to extract sufficient profit from these price points, while carrying significantly higher production and marketing costs (including higher milk cost, transport and servicing costs) than the local manufacturers.

The chart below indicates typical price points for premium yoghurt pots in the UK market.

Figure 10 - Price Points in the UK Premium Yoghurt Market



This highlights that the majority of premium yoghurts in the UK have price points between 31 and 39 per 100g. While there are examples of products that sell above these prices, such as River Cottage Organic Yoghurts (which retail at around £1.00 / 100 g), they tend to be very low volume niche products. We understand that the basic ex factory gate price of yoghurts from the JD is in the region of 25p and to which needs to be added transport and distribution costs, as well as the basic retail margin which could be in the region of between 30 – 50%.

Established price ceilings for dairy products at retail, combined with Jersey dairy’s relatively high raw milk price, means that the JD margins would be under greater pressure than those from local manufacturers.

In our opinion, the decision to target and develop the UK export market is a natural and logical decision for the Jersey dairy industry. What we have not seen from the JD is a fully convincing analysis of how these export markets will be developed - and with what products. Feedback from interviews with the JD have suggested a range of products varying from the apparent current focus on premium yoghurts to a broader dairy deserts category to industrial ice cream mixes and branded bulk butter. While it may be true that all of these products have export potential, the importance of exports to the future of the Jersey dairy

industry and the limited resources available at the JD mean that the export development programme needs to be approached in a highly structured manner.

A detailed analysis of the export market opportunities for Jersey dairy products including demand and competitor analysis, as well as development of realistic costings, based on current and future dairy factories, would allow the JD to fully evaluate the different product opportunities. A further ranking and prioritisation of the various options would then allow Jersey dairy to allocate the maximum resources to develop highest return products in the shortest possible time frame. Such analysis would also potentially provide the wider Jersey dairy industry, and other stakeholders, with increased confidence in an export based dairy recovery plan.

9.5 Summary

In summary:

- liquid milk demand is for 9 million litres on the Island, plus wastage and that needed for balancing and buffer products – this gives the current figure of c. 14.5 million litres
- if the JMMB and JD focus only on liquid milk (as some have suggested as being a viable option for the future) – this is a “one way ticket” to a dwindling industry – assuming that liquid imports come in at some stage – 9 million litres goes down to 7, then 5 etc over a period of years
- once production is cut - it is difficult to bring back – might take 3 years to recover
- cutting production now and/or in the short term gives limited options for JD to develop added value products and removes the option for exports to the mainland, however difficult - in effect, the JMMB and JD are permanently stuck in a downward commodity spiral
- exports give the industry hope for the future – but need to be better planned – and they might not be as profitable as hoped for – but critical for future growth of sector
- what will the impact be on producers – if better combination of volume of products and price is achieved – then it might help maintain the liquid price to farmers – but not likely to increase – 33p is as good as it is going to get

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The Jersey dairy sector must look to achieve a combination of reduced milk cost and better factory processing and reduce quota (by buying up and not re issuing if required) to achieve any form of success in the future.

10. THE SITUATION IN GUERNSEY

10.1 Background

The Guernsey dairy industry has faced many of the same issues as that on Jersey over the years. The States of Guernsey first intervened in the dairy industry in 1937, and the dairy assumed responsibility for the distribution of all milk on the Island during the Second World War, while the Island was under occupation. A new dairy was built in 1951 with surplus milk made into butter. Cheese was also manufactured from the 1970's, with yoghurts first being produced in the 1980's (although this was ceased in 2001). The dairy underwent a major upgrade in 1989/90.

There was a major review of the dairy industry in 2000. The background was that 10 million litres per year was being produced against an annual consumption on the Island for liquid milk and its by-products (cream and butter) of only 7.8 million litres of milk. As a result of the review, contracts were drawn up with supplying farmers that addressed three elements of:

- **Environment and countryside** - including implementing effective farm waste management systems to reduce the risk of pollution
- **Milk supply contracts** - an agreement was signed with the dairy to produce specified volumes of milk
- **Animal welfare and breed development** - an agreement was signed to follow codes of practice covering animal welfare and breed development

A new, modern branding and packaging design for the dairy was introduced in 2002.

10.2 Scrutiny Review - Milk Distribution Proposals

The Scrutiny Committee published a review of milk distribution proposals on the Island in May 2006. The background to the review was that at the end of September 2005 the Commerce and Employment Department announced that it would be removing restrictions on the retail price of milk with effect from 30th October 2005. It also stated that it would be submitting a States Report to the November States meeting that would set out proposals for the future of the dairy industry and include a recommendation to repeal the Milk Law. A common "gate price" for milk purchased from the dairy was set at 56 pence a litre for all customers. These proposals were subsequently delayed, pending the Scrutiny Review.

It is important to note that the Scrutiny Panel stated that it did not feel that the Department had yet to make a case that a free market would be in the best interest of protecting the future of the dairy industry and the State's investment in it. It also believed that the Department did not give proper consideration to the potential benefits of retaining legislative control or consider any alternative solutions to meet its objectives.

The Scrutiny Review made a series of recommendations. While broadly agreeing with the Commerce and Employment Department's plans, the Scrutiny Review felt that their haste in bringing the changes forward, its plans for implementation, and its communication of the strategy were flawed. As a result it made a series of recommendations to rectify the situation.

10.3 Other Relevant Issues

These include the following:

- **BSE** - both Jersey and Guernsey were badly affected by BSE, but the incidence on Guernsey was much higher, despite the smaller cow population. If Jersey had suffered the same rate of incidence as Guernsey, there would have been a significant chance that milk imports onto the Island would have been necessary
- **Breeding policy** - the world population of Guernseys is much smaller than that of Jerseys. Therefore, the primary concern of the breed has been to establish a large breeding programme. The Guernsey Global Breeding Programme has been established under which herd owners on the Island and in the UK commit a proportion of their cows to it. They must agree to take semen from several of the programme bulls each year (Island, UK and overseas) and to record their heifer calves into a first lactation
- **Land use** - the dairy industry on Guernsey accounts for 80% of all farmed land on the Island and, as such, is the dominant agricultural enterprise in determining the appearance of the farming landscape. This is in contrast to Jersey where the potato industry is the dominant agricultural enterprise, with the dairy industry being an important second

10.4 Conclusions

It is difficult to draw too many direct lessons from the situation on Guernsey, given that the Island's dairy industry is currently in the process of being reformed, albeit against a similar background to the situation being faced on Jersey.

The Scrutiny Committee's recommendations on Guernsey should provide some sensible guidance to the way forward on Jersey, in the context of making radical reforms to the dairy industry, albeit that the reforms on Jersey are likely to be different. In particular, their

recommendations that a phased approach to the introduction of changes should be taken, that legal advice is sought with regards to the legislative control of the industry, and that a fallback position should be established, should be noted.

II MILK MARKETING OPTIONS

II.1 Introduction

These are set out as follows:

- Option 1 – the modification of the current MMS
- Option 2 – the JMMS remains, but only deals with the liquid milk market
- Option 3 – a totally free market
- Option 4 – a free - er market but with some external controls
- Option 5 – the development of a Farmer Controlled Business (FCB)

Evaluation of Options

For each option, we have set out what we see as being the key features of the option. This is in terms of who might be the key players on the Island, who would be the milk buyers, how price mechanisms would operate, how volumes would be set and what these might be. We have also indicated what we believe to be the [indicative] prices for both farmers and consumers.

We have then evaluated each of the options. This is in terms of its legal robustness, how compliant we believe it to be with competition issues, what the impact of the long term viability of the Jersey sector would be, the impact on farmers and the benefits to consumers – as well as how far it might government objectives.

11.2 Option I – Modification of the MMS

Description

The main features of Option I would be as follows:

Summary	<p>In effect, the MMS could be changed from a JMMB prescriptive monopoly system to a statutory monopoly to buy all milk produced on Jersey farms</p> <p>A modified MMS would see the JMMB as still being the only buyer of milk from farmers on the Island, but it could still sell to a range of processors</p>
Milk processors	<p>It would provide opportunities for the JD, along with some potential for small entrepreneurial or niche milk processors, to produce dairy products that are largely complimentary to the JD</p> <p>The JD would focus on producing a range of ingredients and consumer products to generate the best returns from its milk intake</p> <p>The business would focus on the Jersey market primarily, but also work on developing profitable export markets</p>
Milk buyers	JMMB only
Price setting mechanism	The milk price would be set by JMMB although essentially based on the profitability of Jersey Dairy.
Production volume setting mechanism	The overall milk production volume would be controlled by via the milk licensing system administered by JMMB
Milk buying process	<p>JMMB would remain the single buyer of milk on Jersey</p> <p>All milk producers would be obliged to sell to the JMMB or to reach an agreement with the JMMB to use their own milk in their milk processing</p>
Estimated milk volumes	<p>Under an extension of the current system the overall milk volumes are likely to decline slightly as a natural percentage of farmers exit the business.</p> <p>Milk produced on Jersey would remain at a level of c. 14.5 million litres</p>
Indicative milk prices (farm)	33 ppl – based on the fact that this option in effects retains the status quo on the Island
Indicative milk prices (retail)	In the short term, milk prices to the consumer might fall to a level of 75 – 80 ppl (based on current projections made by the JD in its business plan) and some limited, small scale competition from other processors

In terms of its overall impact on the future development of the dairy sector on Jersey, this can be summarised as follows:

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Issue	Evaluation
<p>Legal robustness & implications</p>	<p>Any alteration and/or modification to the current MMS would in effect buy some more time for the Jersey dairy sector but can be challenged by commercial companies at an EU level - we believe this challenge would come quickly</p> <p>A modification would in effect look to preserve the status quo of the sector as it currently is for at least the short to mid term</p> <p>A similar structure in the Jersey potato industry was deemed to be illegal</p> <p>Further legal proceedings would only serve to deepen and prolong any divisions that exist within the industry as to the role of the JMMB on the Island amongst farmers. It will also continue to create uncertainty in the industry. This will prevent new investment and increased efficiency at farm and factory level</p> <p>An alternative way of achieving the same effect exists – by the issuing of a PPE (for a specified period) and this option is less likely to require more protracted and costly legal challenges</p>
<p>Competition Law Compliance</p>	<p>Current legislation is being challenged by JCRA</p> <p>There are already questions whether the MMS in its current form is legal</p> <p>While the Jersey Government could attempt to defend any change in the status of the MMS, there are doubts whether this would pass all the necessary stages required to change the law. Even if it was passed, it would take at least between 6 – 9 months to achieve this</p>
<p>Long-term viability for the Jersey industry</p>	<p>The assets of the JMMB and JD would be protected (as now) for the benefit of the industry – at least in the short term from any aggressive move to seek them being shared out amongst farmers (although as we have indicated if a new factory is constructed and some of the debts paid off, we do not think that there will be that much left over to pay out to farmers anyway)</p> <p>However, even with full government support for what in effect would be a continuation of the JMMB in its current format, there is no real protection against commercial challenges to the monopoly</p>

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	<p>milk buying status of the Board</p> <p>Under this system the milk prices on Jersey are likely to remain higher than in other external markets</p>
Preservation of Jersey cows on Jersey	High – it is likely that the maximum number of farms and herds would be preserved under this Option at least in the short term
Consumer pricing & benefit	<p>Limited – milk pricing would (at least to wholesale levels) would be at the discretion of JMMB</p> <p>There is no clear view of what the impact might be on the price paid by consumers for milk on the Island: the real benefit of this option is to the dairy farming sector and the JMMB. It is most likely that the price paid for by consumers would decline slightly as proposed in the Jersey Dairy recovery plan, while the status quo is retained</p> <p>However, it is in the JMMB's best interest to reduce the UK – Jersey milk price premium, as this would reduce the risk of commercial challenges to the import licensing system. JMMB data suggests a target milk price of 70 ppl is actually required</p>
Impact on Jersey dairy farmers	<p>Minimum – this option ensures low levels of competition and limits the impact of EU and world prices on Jersey farmers</p> <p>It is likely to assist the maximum number of Jersey farmers remain in the industry and for the maximum prices to be paid to Jersey farmers. (at least in the short term)</p> <p>It would prevent internal farmer competition at least in the short term</p>

Conclusion on Option I

Option I – of looking to modify the current MMS - will in effect buy some time for the Jersey dairy sector – but probably not much more than this. This can only be justified if the time is used to maximum effect – and the key aspect here would be to be make full use of this time to build the new JD factory which is so badly needed. However, it only deals with the internal threats that exist on the Island as to the position of the JMMB. It does absolutely nothing to deal with the threat of imported liquid milk, which is a critical issue for the successful development of the sector.

The JMMB and JD might well argue that protecting the domestic market in the short term is essential to allow them time to lower costs and develop export markets – and to a degree they are right. The reality is that the time they have to do this is beginning to slip away and action needs to be taken now to safeguard the future structure of the dairy sector.

The legal possibility of actually achieving this modification is not proven – and it may take some time (at least 6 – 9 months) to actually put in place even if it can be achieved. It is likely that even if it were achievable, it would be challenged almost straight away. Another damaging and energy sapping legal case is the last thing that the Jersey dairy sector needs – not least it sends out very negative signals to potential customers, both on the Island and even more importantly potential new customers on the mainland. It would also highlight the lack of internal certainty as to the future of the industry – one that is constantly under challenge and therefore produces a lack of confidence in the industry, low investment etc.)

Rather than look to modify the existing scheme, the buying of time that is required can be achieve by the application of a PPE which will achieve the same end result but only for a specified time. However, again it does not deal with the real issue of beginning to position the Jersey dairy sector to deal with the external rather than the internal threats to the sector that exist and which are the real drivers for the mid to long term development of the industry.

There is only limited consumer benefit to be derived from Option I but government objectives – *green fields, brown cows* – are largely met. This option maximises the number of cows in Jersey and provides the highest (short term) returns at least to farmers.

11.3 Option 2 – The JMMB is retained, but only deals with liquid milk

Description

The main features of Option 2 would be as follows:

Summary	The JMMB & the JD would focus on supplying liquid milk only for the domestic market
Milk processors	<p>This structure would provide opportunities for the JD along with some potential for small entrepreneurial or niche milk processors to produce added value dairy products that are largely complimentary to the JD</p> <p>The JD would focus on producing liquid milk products for the Jersey market only (although small volumes of butter or cream would still be made to manage bufferfat)</p>
Milk buyers	The JMMB only for liquid milk
Price setting mechanism	The milk price would be set by JMMB although essentially based on the profitability of the JD
Production volume setting mechanism	The overall milk production volume would be controlled via the milk licensing system administered by JMMB
Milk buying process	<p>JMMB would remain the single buyer of liquid milk on Jersey</p> <p>Any other milk producer would be obliged to sell to the JMMB or to reach an agreement with the JMMB to use their own milk in their processing</p>
Estimated milk volumes	Milk produced on Jersey in the region of between 9.5 – 11.5 million litres
Indicative milk prices (farm)	33 ppl
Indicative milk prices (retail)	c. 70 ppl

In terms of its overall impact on the future development of the dairy sector on Jersey, this can be summarised as follows:

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Issue	Evaluation
<p>Legal robustness & implications</p>	<p>The JMMB still remains, in effect, a monopoly organisation</p> <p>It is likely that the monopoly of the JMMB in the local liquid milk market would be challenged and this would probably happen quite quickly</p> <p>Maintaining the JMMB however would mean that there would be a limited opportunity for asset stripping</p> <p>Option 2 does nothing to address the issues of what happens if imports come on to the Island and acts as a hindrance to export development</p>
<p>Competition Law Compliance</p>	<p>The role of the JMMB in terms of its monopoly on liquid milk purchases ex farm on the Island is still likely to be challenged – further damaging legal battles should be avoided, not least because of the negative signals it sends out to customers and other key industry stakeholders. There is also the issue of the on going uncertainty and lack of industry confidence as in Option 1</p>
<p>Long-term viability for the Jersey industry</p>	<p>The liquid milk market on the Island – as it is in most developed markets, is seen as being flat with no anticipated growth</p> <p>There is no opportunity for exports which are seen as being crucial for the future development of the sector</p> <p>There is no opportunity for the development of added value products which is where the limited growth (if any) opportunity in the Islands domestic market would exist</p> <p>There is still an issue of what to do with the cream by product that will exist – this would normally be made in to packed butter or be exported to a specialist processor</p> <p>The JD operation would see a loss of any economies of scale and begin to lose critical mass</p>
<p>Preservation of Jersey cows on Jersey</p>	<p>Medium – there would probably be a decline in cow numbers over a period of time</p>

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	<p>As a result of this decline in cow numbers, there would be some adverse environmental issues on the Island to contend with</p>
<p>Consumer pricing & benefit</p>	<p>Medium – high - a streamlined JD focussing mainly on liquid milk would allow for increased processing efficiency and lower costs. These savings could be passed on to consumers via lower milk prices</p>
<p>Impact on Jersey dairy farmers</p>	<p>High – the impact from this scenario would be an initial reduction in milk license from 14.5 million litres to a liquid milk only level of 9.5 million - 11.5 million litres.</p> <p>To be truly efficient, this level would have to decrease even further to very closely match supply and demand (under this scenario it would still be costly to process milk that was above that required for liquid milk consumption)</p> <p>Long term, there are limited growth opportunities and the scenario would send clear signals to the industry that dairy farming on Jersey was in a managed decline phase</p>

Conclusions on Option 2

Option 2 is what we believe to maybe the “*worst of all worlds*” – the liquid milk market on the Island is still under the control of the JMMB. However, the JD has no opportunity to operate in the growth markets of exports to the UK and then the more modest growth that might be achieved in the local added value markets.

The JMMB in effect remains a statutory type body for the local market. This option does nothing to deal with the threat of imported milk on to the Island and acts as a hindrance to exports. Cow numbers will decline over a period of time - as a result Government objectives – *green fields, brown cows* - will not be met. There are medium – high benefits to the consumer of seeing liquid milk prices reduced to potentially around 70 ppl.

In the mid to long term, the JD would begin to loose critical mass and even in the situation of Option 2, the role of the JMMB in the domestic market could well be challenged. And as we have stated under Option 1 - further damaging, expensive and energy sapping legal cases should be avoided – not least because of the negative signals it sends out to customers on the Island and the mainland too, as well as other key industry stakeholders.

11.4 Option 3 – A Totally Free Market

Description

The main features of Option 3 would be as follows:

Summary	<p>The dairy industry would be totally deregulated</p> <p>There would be no controls on milk purchasing and the import licensing system would be removed</p>
Milk processors	<p>The free market environment would provide potential for the JD, other liquid milk processor(s) and/or importers and niche milk processors producing other dairy products</p> <p>The intense price competition that is likely to result from this model would force all dairy companies in the market to lower costs to maintain market share</p> <p>A worst case scenario could see the JD acting as a milk wholesaler & distributor only, importing all its milk from other UK and European sources</p>
Milk buyers	<p>Individual milk processors would be responsible for sourcing their own milk supplies either from Jersey farmers or international milk producers</p> <p>In all probability, the JMMB would cease to exist</p>
Price setting mechanism	<p>The milk price paid by any processors would be based on commercial negotiations between producers and processors</p> <p>However, the availability of milk from the UK would mean that the price paid for milk on Jersey is likely to be based closely on the UK farm gate price plus a margin for shipping milk to Jersey (currently estimated at around 5 ppl)</p>
Production volume setting mechanism	<p>There would be no controls on the minimum or maximum volume of milk produced on Jersey</p> <p>Market forces would set the volume of milk produced</p>

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Milk buying process	Milk processors would be free to seek supply from any producers on Jersey or from UK or other international suppliers
Estimated milk volumes	<p>The overall volume of milk produced on Jersey would be largely dependent on the Jersey farmgate price and the landed cost of milk from the UK or other parts of Europe</p> <p>Assuming prices were similar, the Jersey Industry could produce between 7 – 9.5 million litres, providing the majority of Jersey’s liquid milk demand but could literally in effect range from 0 – 9.5 million litres</p> <p>A less competitive price could see milk production significantly reduced and possibly limited to niche milk processors supplying their own processing plants</p>
Indicative milk prices (farm)	UK conventional farm-gate price + transport costs - 23.5 ppl (cf. the UK Channel Island farm-gate price + transport costs – 28.5 ppl)
Indicative milk prices (retail)	Between 45 and 65 ppl depending on the retail margin taken – either that used in Jersey (up to 65 ppl) or that on the mainland (45 ppl)

In terms of its overall impact on the future development of the dairy sector on Jersey, this can be summarised as follows:

Issue	Evaluation
Legal robustness & implications	<p>Under Option 3, there would need to be a change in the law regarding the issuance of licences for imports</p> <p>These imports would almost certainly be challenged in the first place but in the mid to long term it is unlikely that the challenge could be sustained</p> <p>The potential opportunity for asset stripping would be high</p>
Competition Law Compliance	This system would be fully compliant with local and EU _ competition legislation
Long-term viability for the Jersey industry	<p>Over a period of time, extreme pressure from imports means that increasingly dairy farming on Jersey as it has been known becomes something of a “museum piece – this is the way we used to do it”</p> <p>However, there would be huge pressure put on the JD operation to the point where its future feasibility would be open to severe</p>

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	<p>doubt</p> <p>There would be no Jersey exports to the mainland</p> <p>There would be significant and adverse knock on impacts in all other parts of the Islands dairy supply chain</p> <p>Imports of liquid milk would dominate the market</p> <p>Farmers on Jersey are forced to compete with imports (which can be sold on the Island at a level of c. 45 - 65 ppl) and many would be forced out of business</p>
Preservation of Jersey cows on Jersey	<p>Low - there would be a rapid decline in the number cows on Jersey with significant adverse environmental impacts experienced</p> <p>Government objectives – <i>green fields, brown cows</i> - are not met</p>
Consumer pricing & benefit	<p>High – imports of liquid milk would be of direct benefit to consumers and see the lowest possible price achieved at retail level. However, consumers would need to balance this against the possible loss of the iconic Jersey brown cow and the possibility of the reliance on imported milk producing consumer insecurity and a change in the traditional landscape of the Island</p>
Impact on Jersey dairy farmers	<p>High - Jersey dairy farmers would feel the full impact of EU and world dairy prices</p> <p>Any advantage gained in terms of reduced subsidy to dairy farmers as they are forced to exit the sector would be negated by increased additional exposure to the running of the abattoir and the costs of increased payments to support better environmental practises</p>

Conclusions on Option 3

Option 3 for the Jersey dairy sector is in its current state, a “*short cut to disaster*”. The benefit to consumers is however high – milk is sourced at the lowest possible price, which might be in the region of between 45 – 65 ppl at the retail level. However, the implication here is that all milk could be imported and in its current position, huge amounts of the local market

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would be lost in a very short space of time. Farmers on Jersey would be exposed to the full force of EU and world market prices and find it almost impossible to compete.

There would be significant fall out within the industry in terms of farmer numbers and the number of cows – and government objectives of brown cows in green fields will be tested to the very limit. While consumers win – farmers lose out and the mid to long term sustainability of a dairy sector on Jersey is hugely compromised. Imports of liquid milk would dominate the market and over a period of time, extreme pressure from imports means that increasingly dairy farming on Jersey as it has been known becomes something of a “*museum piece – this is the way we used to do it*”

Even any possible advantage gained by the Government in terms of reduced subsidy to dairy farmers as they are forced to exit the sector would be negated by increased additional exposure to the running of the abattoir and the costs of increased payments to support better environmental practises.

11.5 Option 4 – Free – er Market, Some Import Controls Removed

Description

The main features of Option 4 would be as follows:

Summary	<p>The JMMB monopoly milk buying role would be removed</p> <p>Milk import licenses would be allocated on a limited basis</p>
Milk processors	<p>The more open market environment would provide potential opportunities for the JD, other liquid milk processor(s), importers and/or niche milk processors</p> <p>The increased competition likely to result from this model would force all dairy companies in the market to lower costs to maintain market share</p> <p>With access to milk import licenses Jersey dairy could import a percentage of its milk requirements to minimise its buffer milk needs and maximise efficiency</p>
Milk buyers	<p>Individual milk processors would be responsible for sourcing their own milk supplies from Jersey farmers</p>
Price setting mechanism	<p>The milk price paid by any processors would be based on commercial negotiations between producers and processors</p> <p>However, the current relatively high liquid milk prices are likely to create intense price competition as any new entrants attempt to gain market share</p>
Production volume setting mechanism	<p>There would be no controls on the minimum or maximum volume of milk produced on Jersey</p> <p>Limited volumes of milk would be allowed to be imported</p>

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Milk buying process	<p>Milk processors would be free to seek supply from any producers on Jersey</p> <p>In addition to domestic milk production, limited volumes of milk would be imported</p> <p>Import licences would be granted to “selected” companies such as the JD</p>
Estimated milk volumes	<p>Under this scenario, the JD is likely to remain the largest milk processor on Jersey and the majority of milk is likely to be produced on Jersey</p> <p>The most efficient way for the JD to utilise any milk import licenses would be to reduce its overall milk intake to around 60 – 70% of liquid milk demand and use then imports to manage the buffer between raw milk supply and actually demand</p> <p>Milk produced on Jersey could be forced down to as lows as between 6 – 7 million litres</p>
Indicative milk prices (farm)	Farm gate prices would be driven down over time to c. 28 –29 ppl
Indicative milk prices (retail)	Between 45 – 65/70 ppl depending on the retail margin taken on the Island

In terms of its overall impact on the future development of the dairy sector on Jersey, this can be summarised as follows:

Issue	Evaluation
Legal robustness & implications	<p>Under Option 4, this would require a series of law changes relating to removing the JMJB and then selectively allocating import licences to the JD and others that might apply for one</p> <p>It might be more difficult from a legal perspective to have a “semi free” market rather than a totally free one, not least in dealing with how non JD suppliers are allocated with milk licences</p>
Competition Law Compliance	Option 4 is likely to be compliant with local competition law at least in the short term, but longer term may still not be fully compliant– if in effect as a result of re consolidation in the mid to long term, a private monopoly might be created
Long-term viability for the Jersey industry	With a number of dairy processing operations on the Island, all fighting for market share in a limited domestic market, there will be a loss of any economies of scale with no one operation achieving the required critical mass necessary for the development

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	<p>of exports – exports are critical for the future development of the sector</p> <p>It would produce more competition on the Island – at least in the short term</p> <p>It would allow for opportunities for niche players to develop</p> <p>There is a limited opportunity for asset stripping as the JD in effect remains in place but in open competition with others on the Island</p>
Preservation of Jersey cows on Jersey	Low – cow numbers would be reduced and there would be associated stress in other areas of the dairy farming supply chain
Consumer pricing & benefit	Medium – it would produce a lower liquid milk price for consumers – but not the lowest
Impact on Jersey dairy farmers	<p>Medium – High – inter island competition could lead to a milk price war – lower milk prices are likely to be reflected in lower prices paid to producers which would force a number out of business</p> <p>Option 4 still does not deal with the external threat of milk imports, and this now fragmented Jersey dairy sector is even less able to compete in this respect</p>

Conclusions on Option 4

Option 4 in effect produces the same end result as Option 3, only over a longer period of time. It does not position the dairy sector on Jersey to deal with the combination of imported liquid milk and the development of exports to the mainland – both of which we believe are the critical issues for the sector to deal with.

In the short term, it would probably produce a milk price war – which is good for consumers but bad for dairy farmers and in the mid to long term might not even be that good for consumers either. As the industry is forced to re consolidate, it might be argued that it will eventually produce a “private monopoly” which would be ultimately challenged on a legal basis.

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In reality, Option 4 for consumers produces a lower price for milk, but not the lowest. Over a period of time, cow numbers will be reduced putting Government objectives in to some doubt. However, this decline will not be at the same rapid pace as seen in Options 2 and 3.

A fragmented industry, with no one single player being able to achieve a degree of critical mass will mean that the development of any exports business is put into severe doubt. As we have mentioned several times already, exports are critical for the future development of dairy farming on the Island. It might also be more difficult from a legal perspective to have a “semi free” market rather than a totally free one, not least in dealing with the question of if (and how) farmers not involved with the JMMB are regulated with milk licences.

Something akin to a “half way house” scenario, Option 4 is most likely to produce a “*slow route*” to disaster rather than the “*quick route*” that would be produced under Option 3.

11.6 Option 5 – Creation of A Farmer Controlled Business

Description

The main features of Option 5 would be as follows:

Summary	<p>The monopoly milk buying powers of the JMMB would be removed</p> <p>The milk import licensing system would ideally remain in place for as long as possible – but it needs to be recognised that in the mid to long term that if this is challenged at EU level, that imports cannot be prevented</p>
Milk processors	<p>Not all farmers are required to join the new structure – there is choice to be made here and some might choose to operate outside of the new structure. We have made comments in the report that some will find this more difficult than they first think</p> <p>However, the free milk market and the initially high wholesale milk price would create opportunities for a range of milk processing companies to develop on Jersey with direct links to the primary supply base and which would produce a more competitive market environment per se</p> <p>However, to prevent a fragmented and overtly competitive domestic liquid milk market, the majority of dairy farmers (both in number and milk production) choose to voluntarily form a new generation format co-operative (i.e. an FCB)</p> <p>The FCB would focus on using profits from the liquid milk market to develop high value niche export market for ingredient and or consumer products</p>
Milk buyers	<p>Individual milk processors would be responsible for sourcing their own milk supplies</p> <p>However, the JD would still be by far the largest milk buyer on the Island - we anticipate that this might be up to 80% of milk supplies but will depend on the compelling reasons that the JD can set out to farmers to join the new FCB</p>
Price setting mechanism	<p>The milk price paid by any processors would be based on commercial negotiations between producers and processors</p> <p>However, as a FCB, the JD would aim to pay its members the highest price possible –but at the same time have a very strong market and customer focus</p>

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Production volume setting mechanism	<p>Initially, the production volume for the JD Co-operative could be managed using the existing licensing system</p> <p>However, overtime the system could move to a more commercially based system agreed by FCB members</p>
Milk buying process	<p>Milk processors would be free to seek supply from any producers on Jersey</p> <p>However, the majority of milk producers would have voluntarily agreed to supply their milk to the JD</p>
Estimated milk volumes	<p>Assuming the majority of milk producers commit to supplying JD, the overall volume of milk may not change significantly in the short term</p> <p>In the longer term, the growth of milk would be largely based on the export marketing initiatives of JD management</p> <p>Production would be in the range of between 9.5 – 14.5 million litres</p>
Indicative milk prices (farm)	<p>Under Option 5, price at the farm gate level would be subject to market forces and for the successful development of exports to the mainland UK this needs to be reduced, probably down to less than 30 ppl</p>
Indicative milk prices (retail)	<p>The retail price level of milk would be in the region of 65-70 ppl, again depending on the retail margin taken. This is based on the typical existing retail margin incurred on the Island or the typical margin made in the UK and which might be used as and when a UK retailer enters the Jersey market.</p> <p>This sort of price level can be achieved over a period of time through a reduced farm gate price and the significant efficiency gains made by the construction of a new modern dairy processing factory. At the upper level, it is in line with predictions made by the JD as to where it might need to operate in the future.</p>

In terms of its overall impact on the future development of the dairy sector on Jersey, this can be summarised as follows:

Issue	Evaluation
Legal robustness & implications	<p>This option required a series of complex and delicate legal changes to be carried out over a 2 –3 year period</p> <p>The highly controlled and managed change over in status means that there is no opportunity for asset stripping</p> <p>A FCB structure is totally defensible against possible legal challenges as are being seen at the moment and might be seen again in the future</p>

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<p>Competition Law Compliance</p>	<p>It is likely that this sort of industry structure would meet the current concerns of an organisation such as the JCRA</p>
<p>Long-term viability for the Jersey industry</p>	<p>A FCB structure is more likely to gain support from mainland customers rather than a statutory style marketing board</p> <p>The JMMB shares held in perpetuity for dairy farmers become held in perpetuity in a FCB model which reduces the opportunity for asset stripping</p> <p>At the same time, the removal of monopoly power allows for the development of niche entrepreneurs to operate in the market</p> <p>It is highly dependent on the creation of a new dairy factory – this is required to build farmer confidence in the new organisational structure and the development of a compelling vision for the business set out to the Island’s farmers</p> <p>The JD in effect becomes a FCB and remains the major player on the Island probably accounting for c. 80% of milk supplies</p> <p>This transition would only happen over a 2 – 3 year period – with the date for industry change set out well in advance – while a new dairy factory is being built (which could be done in a period of 12 – 18 months maximum)</p> <p>Farmers would have to decide if they are either “in or out” of the new FCB</p> <p>There is no need for a JMMB function – there are some minor savings to be made in terms of JMMB salaries etc</p> <p>This allows for the JD to be able to better positioned to deal with the threat of imports</p> <p>The supply chain between the JD and dairy farmers is shortened in line with key trends in modern food producing operations in other parts of the world</p> <p>It represents a fundamental change in the way that the dairy sector in Jersey is managed and some will resist it, and or even try to delay it – at the same time, others will rise to the challenge</p>

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<p>Preservation of Jersey cows on Jersey</p>	<p>Medium – the JD remaining the critical player in the sector allows for the retention of a degree of critical mass – Option 5 does not prevent dairy farmers exiting the sector and in fact in the very short term might even acerbate it</p> <p>However, in the long term, this model provides the best opportunities for growth of the industry on Jersey – this is where the critical difference is with Option 1</p>
<p>Consumer pricing & benefit</p>	<p>Medium – a degree of competition in the internal market will allow for a lower cost of liquid milk, but not the lowest to consumers, and accept that this situation is required to retain the iconic status of the Jersey brown cow on the Island</p>
<p>Impact on Jersey dairy farmers</p>	<p>High – there is a more streamlined decision making process in terms of the JD procuring the milk it wants at the time it wants it – and of the quality it requires</p> <p>There is an element of “a new start” for the Jersey dairy sector with the more adverse elements of “the baggage” of the last 50 years finally left behind</p> <p>If there is no effective leadership and/or associated vision effectively communicated to dairy farmers on Jersey, it is unlikely that they will join up for this development – there is a need to consider fully the implementation issues that will arise as a result of this (See Section 11.6)</p> <p>This option is not without risk – and new ventures without an effective supply chain allied to an efficient factory and top class management – are not mandated to automatically succeed (again see the comments we have made on implementation)</p> <p>The Jersey dairy model is brought in to line as being similar (but maybe not the same) as others around the world</p>

Conclusions on Option 5

We believe that Option 5 is the most appropriate for the dairy sector in Jersey to consider:

- it provides a genuine long term solution for the industry – but this is not to say it is without risk - and this is discussed later on – not least it requires a strong industry vision and leadership to “sell” the concept to the dairy sector and other key stakeholders on Jersey
- it is likely to address the concerns of organisations such as the JCRA
- a more competitive environment on the Island will see some consumer benefit in terms of milk price paid
- it is a proactive solution for the sector and avoids potentially further damaging internal legal action and/or having a solution and/or industry structure imposed on it externally
- it deals with both the internal and external issues confronting the sector – the development of exports and looking to produce a more efficient supply chain on the Island (i.e. more efficient farms and cows, a more efficient factory etc)
- the JD remaining a key player on the Island allows a degree of critical mass to be retained and cow numbers will be retained – having said this, Option 5 does not prevent farmers exiting the sector – and in the very short term, might even acerbate this
- it provides an opportunity to develop the new factory required and which is critical for exports - it also reduces the opportunity for asset stripping – although a careful change over will be required here
- it needs to be achieved over a period of time in a controlled and managed fashion
- it represents something of a “new start” for the dairy sector and leaves behind much of the negative baggage of the past
- it has been achieved in other dairy producing countries – albeit it not without some pain

To pretend that this can all be achieved without some risk would be naive though. Some the relevant issues here are discussed below. Essentially, these revolve around questions over industry vision and leadership, the building of the new dairy processing plant and the creation of export markets as well as how assets are protected and transferred during a period of change. Not least, careful consideration needs to be given as to what sort of time frame is required to achieve this sort of change in industry structure and the future role of Government support.

11.7 Implementation

Implementation of Option 5 - which we strongly believe is the most appropriate for the development of a sustainable dairy industry in Jersey – also poses the most challenges and would require the longest implementation time frame to ensure success. The critical factors to take in to account would be as follows:

- **Industry leadership and vision**

Industry leadership needs to recognise that change is inevitable – and this is driven largely by the external factors surrounding the unsustainability of a monopoly milk buying system, milk imports and the development of competitive exports to the mainland UK - and that the best option is to be proactive and manage the change, rather than have it forced on the Jersey industry by external industry stakeholders.

A proactive stance is we feel far more likely to have a positive overall impact rather than adopting one of “looking to protect what we have for as long as we can”. It is clear though that a realistic and planned timetable of change is required – this should probably be for between 2/3 years – but if it was possible to obtain further time - it should be taken. However, this programme of change should not be spun out and it is essential that any time available be made the very best use of.

The industry leadership also needs to sell the idea of controlled and managed proactive change to dairy farmers on the Island and provide the vision for the future that is credible with industry. The vision of a **single** united, strong, well equipped and market led co-operative as the best option needs to be sold to producers – as it has been in other parts of the world in the run up to significant industry changes. The development of the Fonterra dairy organisation in New Zealand is a good example of this.

While recognising that the scale of the New Zealand dairy sector is very different from that of Jersey, we believe that a number of similar analogies can be drawn vis a vis the development of the sector. Not least, Jersey should be looking to benchmark against itself against the “best in class” which the New Zealand dairy sector undoubtedly is. Not least, like Jersey, the New Zealand dairy sector is:

- fundamental to the agricultural sector in the country and to the overall make up of economic activity per se
- it has a long heritage of dairy farming
- it is an Island economy
- it is export driven – we believe that Jersey needs to be
- it has strong international competition and in some cases barriers to trade (both tariff and non tariff based) to overcome
- it has made significant investments in new processing activity both in New Zealand and in other international markets
- it has invested in developing strong supply chain relationships with both customers and other dairy supply chain partners
- it has strong environmental credentials to promote and protect
- dairy farmers are coming under pressure from other alternative land uses, including both agricultural and food sectors (i.e. the wine industry, which is a huge growth area in New Zealand) as well as from other industrial sectors

The New Zealand dairy sector is of course not without its problem areas.....

Farmers are under pressure from both international customers and other suppliers in Latin America such as Brazil and Argentina.

New market opportunities in China and the Pacific Rim are extremely challenging. Traditional markets such as the UK and the rest of the EU are mature and offer only limited, if any growth opportunities. Environmental pressures are increasing both on the farm and in other areas of the supply chain, such as the debate on food miles. Moving from competing in commodity markets to a higher added value positioning is not achieved overnight.

Regardless of these issues though, the New Zealand dairy sector is regarded by most industry observers as being “best of class” and we believe that Jersey can gain much by benchmarking itself against “the best rather than the rest”.

While the scale of the New Zealand dairy sector is of course much larger compared to Jersey, much can be learnt from the way the New Zealand dairy sector has chosen to structure itself and how it operates in a hugely competitive market place.

- **Export markets**

As we have stated in the main body of the report, we believe that the development of exports are critical to the future of the dairy sector on Jersey. The critical issue here though is that exports really have to be providing a greater return than the return of the domestic market does. They cannot be regarded as a “useful return to the overall business” and a way of mopping up surplus milk which is not required for the local market on the Island.

The export business will over a period of time become the key driver in the JD business – in most other top class agri food export businesses, it is the best quality and highest added value products that are sent to international markets. International markets are where the premium products are traded and premium prices earned.

With significant investment in the dairy processing factory envisaged this can only be justified by gaining access to and then sustaining exports to high value growth markets – which is what the mainland UK represents –and the local Jersey market, with a population of just 80,000 cannot. We also firmly believe that as part of any industry communication plan, the clear viability of the export business needs to be proven and then disseminated to dairy producers.

The JD has made some encouraging progress in this area over the last 6 months – but precious little in the previous 48 months, albeit for reasons which are well understood. However, the reality is that there is a good deal of work to be done here over the next 18 months and only a focused, dedicated and highly professional effort will be sufficient.

- **Development of a new factory**

The development of a new, modern and efficient factory is a fundamental part of the forward industry plan – not least in order to give dairy farmers on the Island confidence for the future and “that this is for real”. A new factory is especially important for the development of exports to the mainland UK market. We strongly believe that HDF is the best site for this and that any further delay in granting the site to the JD will be very counter productive. Work should begin as soon as possible.

Implementation

It is clear that there are some areas that will required detailed attention so that the transition goes as smoothly as possible. It might be useful to look at the process by which this was achieved in other parts of the UK in the process of deregulation.

11.8 Key Steps on the Scottish MMB Dissolution

These were as follows:

- **November 1991** – the Minister of Agriculture called upon the UK MMBs to put forward proposals to move towards a voluntary status
- **April 1992** – first proposals were presented by the UK MMBs to government

The Scottish MMB proposal suggested moving seamlessly to a voluntary integrated milk-processing co-operative. The Board's assets would pass into the hands of those joining the new co-operative. The England version suggested separating milk buying and processing operations.

- **Summer 1992** - the Scottish Office issued consultative documents on the SMMB's plans and aspects were also examined by EU Competition Authorities
- **December 1992** - the Monopolies & Mergers Commission reviewed attempts of the SMMB to buy the CWS (presume this was a Scottish Dairy processor). The MMC then issued a report critical of the plans to build an integrated voluntary co-operative to replace the SMMB
- **January 1993** - the SMMB revised its plans and agreed to follow the English style - milk buying business and milk processing business.
- **July 1993** - to change the MMB's existing dissolution process required new legislation. A new act came in after "intense & lengthy debate" in Parliament
- Implementation of the new Act was then to take place on particular vesting days (i.e. April 1994 – but all dates were later changed because of difficulties in meeting the timetable)
- The Act required the MMB's to provide schemes for re-organisation and set out details for the procedure. In considering these schemes, the Minister considered 8 major points including:

- the MMB had informed producers of the proposed changes
 - the proposals met requirements of the Act
 - the proposals would allow for the development of competition in milk marketing
 - that the scheme took account for the interests of consumers
- **October 1993** – all the MMB's submitted detailed re-organisation schemes to the Government. The Government then summarised these into consultation documents and comments from interested parties were invited. Feedback was received and on the back of this, changes were made to the operations of the co operatives
 - **March 1994** - new consultation documents were issued
 - **June 1994** - the Minister of Agriculture announced that the re-organisation scheme was acceptable and a vesting day was set for 1 November 1994

11.9 What Lessons Can Be Learnt From This Process?

These can be summarised as follows:

- maintaining processing capacity is essential. This needs to be agreed and ensured at the outset.
- this process takes time – unless it is well planned it could take at least 2/3 years to implement, but to minimise any time:
 - the industry needs to want the change and needs to convince the States of Jersey that it is a good idea – to ensure that legislative changes are passed easily
 - the States needs to ensure that the JMMB is aware of what is desirable and feasible in setting up a new structure – this will save time going through the process of public consultation
 - the JMMB needs to put forward a sensible proposal for the new structure and one that is compliant with competition law etc.

11.10 Key Points Regarding Assets

- **Scotland**

Shares in the processing business, Scottish Pride, were issued to producers registered with SMMB, in proportion to the quantity of milk sold by them to the SMMB in the 6 year period to March 1993, and producers who ceased production in that period still qualified. There was a limit on the trading of shares for the first 3 years. After 3 years, the shares were fully tradable. There was a limit of 5% on any shareholding of any person or groups of people acting in consort.

- **England**

All registered milk producers were entitled to a free issue of shares in Dairy Crest plc in proportion to the value of milk supplied by them to the MMB in the year ending 1993. Shares were issued to producers to represent no less than 50 % of the total share capital on flotation.

- **Jersey**

There is a good deal of thinking to be done in Jersey before any major move is made in this direction, but a basic process could be as follows:

- the States of Jersey proposes a change from the JMMB to a voluntary co operative structure
- the JMMB puts forward a proposal and time frame
- the proposal goes out for consultation with key industry stakeholders
- the States of Jersey could then decide whether to change or not
- if the decision is “yes”, this would require a change in legislation.

11.11 Timing & Government Support

Multiple challenges provided by this change in the industry will need the maximum time possible to ensure success. As stated we believe this should be achieved over a period of 2 – 3 years – but if more time can be gained, then it should be used – provided it is used

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constructively and not as part of a “*spinning out process*”. Government should support the dairy sector in Jersey by providing assistance with:

- making a quick decision on the availability – once and for all – on the HDF site
- confirming on going support for dairy farmers as set out in past strategy documents
- granting a PPE for a specified period to give the dairy sector at least some time to re adjust its structure and ensure that the new factory is built – as part of this, the JMMB and JD would need to submit a plan as to how the period of the PPE would be used
- assisting with legal changes that might be required as part of the process of changing from a marketing board to a voluntary co operative
- providing assistance, as might be required, with the provision of specialist change management skills
- providing export market development assistance funded by the Economic Development Department
- Government could (but only on a temporary basis) administer the licensing system to assist with the orderly transition within the Jersey dairy sector

The possibility of achieving what is a major change in the structure of the dairy sector on Jersey will be clearly enhanced by Government giving out clear, consistent and positive signals about the type, level and duration of support that the dairy sector can expect in the future.

12. THE FUTURE STRUCTURE OF THE DAIRY INDUSTRY IN JERSEY

12.1 Case Studies

Before looking at the most desirable future industry structure on the Island of Jersey, we feel that might be useful to look at the experience of a relatively small number of dairy industries that have either been in the same – or similar situation to the Jersey industry currently finds itself in. It is also useful to see what lessons can be learnt and what might some of the expected outcomes be from any change in the industry structure in Jersey over the next few years. To pretend that this might happen without any downsides at all to the value chain would be somewhat naive – but it is also important to look at the positives that can be achieved over a period of time from such a change in the industry structure.

These case studies have been selected as follows:

- Northern Ireland - the de regulation process
- Cyprus – the de regulation process
- King Island, Australia - island based marketing of high added value branded products

12.2 The Northern Ireland Dairy Sector

Background

The dairy industry in Northern Ireland was deregulated at the same time as in England, Wales and Scotland. As a result, United Dairy Farmers (“United”) commenced operation in March 1995. The crucial difference between deregulation in Northern Ireland and the mainland is that United was able to retain control over its processing interests.

The background to the dairy industry in Northern Ireland is that it has always had a relatively large dairy industry in relation to its population, when compared to England, for instance. This means that it has always faced a greater challenge of developing markets for its surplus milk, particularly as the levels of intervention support have reduced.

In the 11 years since formation, United has retained the supplies from the majority of dairy farmers in Northern Ireland and has also significantly developed its processing interests, both within Northern Ireland and elsewhere e.g. Rowan Glen in Scotland. It is currently collecting close to 1 billion litres of milk out of total output in Northern Ireland of approximately 1.85 billion litres per annum. It is owned by about 3,000 milk producers who are its shareholders.

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As well as its roles in collecting and marketing milk, United also provide a range of farm services to its members, including a quota agency, and they have also diversified into the provision of animal feeds and fertilisers, which is not something undertaken by milk buyers on the mainland.

The animal feed business has enabled United to develop feeds, which assist in modifying milk quality and characteristics, which has assisted them to develop markets such as spreadable butter. Another factor which is different in Northern Ireland is the method by which United sells the its milk to its customers- this is done via a computerised auction system. The prices which are paid are widely published and it is generally recognised as an effective and transparent means of selling milk.

United's purchased Dale Farm Dairies Ltd, Northern Ireland's leading liquid milk processor and distributor, in 2001 and amalgamated it with Dromona Quality Foods, its previous processing subsidiary, to create Dale Farm Ltd, now the largest dairy processing company in Northern Ireland. It also includes a subsidiary business which focuses on the sale of food ingredients and bulk dairy products to food processors, food packers and international distributors. Dale Farm purchased Rowan Glen Dairy Products, a specialist yoghurt and cultured product manufacturer located at Newton Stewart in Scotland, in 2002. The feed business, called United Feeds, is a joint venture company.

Lessons for Jersey from Northern Ireland

The positive development of the dairy industry in Northern Ireland in recent years can be largely attributed to the retention of United's processing business at deregulation, in contrast to the situation facing Milk Marque and its successors in England and Wales, as well as the changes in Scotland. Milk Marque's successor businesses, Dairy Farmers of Britain, First Milk and Milk Link, have subsequently tried to rectify this situation through the acquisition of various processing businesses, most recently First Milk's purchase of the own label cheese making business of Dairy Crest.

This strategy is likely to be in the long term interests of the supplying members of these businesses, but, at this stage, it is probably too early to say that this will definitely be the case. The need for an effective processing business is becoming increasingly important with further cuts in intervention buying within the EU.

The success of deregulation in Northern Ireland, relative to the mainland, is likely to have been one of the major drivers in the changes to the distribution of milk production in recent years within the UK. Indeed, the June census figures from 2005 shows that the number of dairy cows in Northern Ireland has recovered recently to be at a very similar level to 20 years ago, and higher (+20,000 or +3.7%) than 10 years ago. This is in contrast to the rest of the UK where cow numbers have fallen substantially during the last 10 years (-27,000 or -12% in Scotland, and -532,000 or -25% in England and Wales).

12.3 The Cypriot Dairy Industry

The dairy industry on Cyprus is run by the Cyprus Milk Industry Organisation (CMIO), which was established by Law in 1969 to secure the interests of the farmers, the dairy industry and the consumers. It co-ordinates, controls and offers guidelines for the production and distribution of the cows' milk on the Island.

Cyprus acceded to the EU on 1st May 2004 (excluding areas that the Government did not exercise effective control over), and its agricultural industry was restructured prior to this. It is important to note that numerically the Cypriot dairy industry is dominated by sheep and goat flocks (approximately 5,000 in 2000); nevertheless milk from cows still forms a very important part of the agricultural structure of the Island. The Island produces liquid milk and other dairy products for usage on the Island, and significant quantities of halloumi cheese (which includes cow's milk, as well as sheep's/goat's- see below), which are sold domestically and to international markets, including the UK. The Island is a net exporter of dairy products.

The population of the whole island is approximately 800,000. Agriculture represented approximately 3.5% of GDP in 2000 (compared to the then EU-15 average of 2.0%). In order to improve the efficiency of the dairy industry prior to EU accession, CMIO introduced radical reforms to the dairy sector. This involved a change to the areas on the Island where they were prepared to collect cow's milk; farmers who were producing cow's milk in other parts of the Island were allowed to switch to milk production with sheep or goats.

The number of dairy herds on the Island has fallen from just under 900 in 1988 to about 250 by 2003. There were approximately 26,000 cows on the Island at the end of 2004, producing a total of 144.5 million litres of milk (compared to total milk output of 121.3 million litres ten years earlier). The milk producer price as of December 2004 was € 41.72 per 100 kg compared to the UK price of €25.17 per 100 kg. The combined output of sheep and goat milk on the Island is approximately 40 million litres.

Lessons for Jersey from Cyprus

The changes that were brought about to the dairy cow sector on Cyprus were very radical but indicate what was thought necessary to enable Cyprus to compete effectively upon accession into the EU. The other relevant issue from Cyprus is the issue of protection for the status of halloumi cheese. It is registered as a protected Cypriot product within the US but not in the EU. The most contentious point regarding this issue is whether the halloumi is produced using sheep and goat milk, or whether it contains cows' milk as well.

The Island relies on including cow's milk in order to enable it to produce halloumi year round. Clearly the issues with trying to obtain Protected Designation of Origin will be different for Jersey "Island" milk/dairy products, but it is relevant to state that such a product specification must include "the authentic and unvarying local methods" of making such a product.

12.4 The King Island Dairy, Australia



- **Key Issues**

Can a small island-based dairy company become a viable exporter?

- **Introduction**

The experience of the King Island Dairy companies provides a leading example of a small branded dairy company that relies on exports as the basis for its business.

- **Jersey and King Island Overview**

	Jersey	King Island
Size	11,600 ha (65,569 vergee)	126 000 ha
Population	Approx. 90,000	Approx. 2,500
Location	49 12 N, 2 07 W English Channel, approximately 22.5 km from the Continental Peninsula, France, and around 161 kilometres south of Great Britain	39°47 S 143°53 E Southern Australia on the Western edge of Bass Strait. The Island is approximately 80 km north-east of Tasmania and about 90 km south-east of Cape Otway on the Victorian coast.
Nearest major metro area	London, England (pop 7.3 mn)	Melbourne, Australia (pop 4mn)
Breed	Jersey	Mainly Friesian
Herd size	3,200	7,500
Dairy farm numbers	33	27

- **Background**

King Island was first settled by sealers in the late 1700's. However, it was not until the late 1890's that dairying on King Island commenced and 1902, before the first Butter Factory was built on the Island and the King Island Butter Factory Co-operative formed. For the next 70 years, the Co-operative focused on producing butter and cheese and went through a number of cycles, at one stage the factory was owned run by Kraft Foods. During the 1950's and early 1960's, the Australian dairy industry boomed. By 1964, there were 197 dairy farmers and 11,600 cows on King Island.

However, by the late 1960's the industry was in decline and the co-operative converted to producing spray dried milk powders. By 1977, a slump in milk powder prices resulted in the business becoming bankrupt. The company was subsequently purchased a private investor and used to manufacture cheese for Kraft Foods under contract for until the early 1980's. By this stage King Island Dairy had less than 30 farmer suppliers.

In the late 1980's, poor performance meant the company was again sold, this time to a group of private investors who also purchased an Australian dairy distributing company, Butterfields. 17 dairy farmers supplied milk to the factory. During the early 1990's, the King Island company backed by its Butterfields distribution network launched a number of new cheddar and white mould cheese products on to the Australian market.

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During the remainder of the 1990's, the company launched a range of new products and secured national distribution in Australia's two major supermarket chains. The company also launched the King Island Black Label range to provide the Food Service industry with a unique range of cheese made in limited supply. King Island Dairy also appointed distributors for their products in the US and across Asia. In 1999, their Roaring Forties blue cheese won Champion Cheese at the New York Fancy Food Fair and in 2002 King Island's Seal Bay Triple Cream won third place at the World Championship Cheese in Wisconsin, USA.

In 2002, the company was acquired by National Foods, which was Australia's largest publicly listed dairy company. According to National Food's managing director "It (the purchase) will deliver a platform for further growth in the high value-added sector of the cheese market and an opportunity to leverage off King Island's technical expertise in our existing cheese business. Today, King Island is one of Australia's leading brands for speciality cheese and dairy products. The King Island name is well known amongst consumers and is synonymous for high quality and luxury dairy products.

- **The King Island Dairy Industry**

King Island is a windswept place that enjoys moderate temperatures and year round rainfall (it has an annual rainfall of over 1000 mm), making it an ideal location to support the Island's beef and dairying industries. Currently 26 farmers manage around 7,500 mainly Friesian cows. The Island is also home to around 80,000 beef cattle. King Island produces around 2,500 tonnes of cheese annually. All cheese is produced on the Island and the factory employs 90 workers.

- **Products**

King Island produces a wide range of speciality cheese and dairy products, including:

- Soft white cheese
- Washed rind
- Blue vein
- Cheddar
- Creams
- Yoghurts
- Deserts

- **Markets**

King Island's main markets are based across all Australian cities. However, with a population of just 18 million, Australia has limited growth prospects and King Island has always looked to

export markets for additional growth. King Island dairy products are sold through distributors in a number of Asian markets as well as the US and even the UK. Wholefoods in the US is a major retail supplier of King Island products.

• **Key Lessons for Jersey from King Island**

These include the following

- **concentrate:** King Island has always focussed and concentrated on processed dairy products. With relatively high cost transport to markets, shipping liquid products has never been an option
- **value added:** since the late 1980's the company has realised the success of the business relied on value added branded products
- **brand focus:** the success of the King Island business has been based on creating awareness and preference for King Island and its products. The company makes extensive use of the Island's landmarks, features and history across its product range Roaring Forties Blue, Stormy Washed Rind, Phoques Cove Camembert and Seal Bay Triple Cream are just some of the well-known examples

King Island Brand – key attributes and positioning

Essence	Values
Tradition and indulgence from an isolated island	Natural
	Benchmark quality
	Rich and creamy

- **management:** King Island Dairy is a brand led company. The management of the company highly brands focussed and the company works with leading Australian brand scientists/ consultants to constantly refine and focus the business

As King Island Dairy grew in the late 1990's one of the logical options was to develop cheese manufacturing capacity on the mainland to lower production and transport costs. However, part of the company's brand essence is based on being from an isolated island. Despite the temptation of lower production costs the company has maintained its 'Island only' production to remain true to its brand.

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- **investment:** as well as investing in brands, King Island has made continued investment in the plant and equipment to ensure maximum efficiency as well as high levels of hygiene and quality

King Island Dairy – A Summary of Advantages and Disadvantages

Advantages	Disadvantages
Low cost production Although King Island is isolated, the mild climate means it is a low cost environment to produce milk.	No natural USP Unlike Jersey Dairy, which as a strong proposition as the home of Jersey cows, King Island has little going for apart from being an isolated and green island. The King Island dairy company has used smart marketing and PR to build the image of the Island and create demand for its products.
First mover advantage King Island Dairy was one of the first dairy companies in Australia to enter the speciality cheese market, as such it has enjoyed a first mover advantage and is still regarded as the speciality cheese manufacturer despite numerous other entrants into the same market segment.	
Management control As a private company the King Island Dairy has worked with its suppliers, but not for them. The company has focussed on the customer to deliver profitability for the company and its suppliers.	

12.5 Summary of Key Lessons

These are as follows:

- it is possible for a key organisation to retain the majority of supplies through the process of deregulation
- there will be some farmer fall out – but there will be regardless
- long term, the process can act as a force for stability in the industry

- farmer owned businesses can succeed
- investment in effective processing facilities is key to future success
- it is possible for small scale operations to achieve international market penetration
- adding value is critical – not getting bogged down, or even trapped in commodity markets
- small producing island based industries can be net exporters
- a more efficient producer sector is likely to emerge
- management focus and a clear strategy are both critical
- investment in brands and technical infrastructure need to be on going
- “first mover” advantage is a big plus
- focusing on customers pays dividends
- USP is useful to have – but means nothing without an efficient production and processing infrastructure behind it
- being truly market led and investing in innovation is also key

Maybe the final “key lesson” for Jersey is that there is “no magic wand” to be waved here. This all takes time, effort, commitment and there will be bumps and bruises along the way. But determined and committed management and strong leadership “from the top” can see these sorts of difficult situations resolved and forward progress achieved.

13. THE FUTURE STRUCTURE IN JERSEY

13.1 Future Vision

We believe that the future structure of the industry in Jersey needs to look like this:

Big Picture Issues – Short Term Priorities

- a voluntary co operative structure should be created which over arches the wider Jersey dairy sector and industry
- the JD is the key and pivotal organisation in the sector
- the factory will have eventually relocated to an efficient and functional (not automatically high tech) site. HDF is the best site available and any further delay in the move to this location should be resisted
- after all commitments have been met – there will not be much left over to pay out to farmers who want to exit the sector. The re development of the factory has to come first as well as meeting other financial commitments. This might be unpopular – but is a harsh reality
- imported genetics are being used but as stated the full benefit of this will only be seen in the long term.
- export development will have been developed to the mainland – but probably not in short term – however there is a need to keep trying in the short term – gaining access to these markets is essential for future growth of the sector
- Government objectives of “brown cows in green fields” are still met there and there will be the opportunity for reduction in a number of government subsidies as farming gets more efficient in the future

Tactical and More Operational Issues

- shorter supply chains and direct contact between producer and processor are the way forward: the JD contracts with farmers on a direct basis for the milk that it needs and wants, rather than the milk it is forced to accept

- the industry – over a period of time becomes more customer facing and less producer focused¹⁰
- there will be a smaller but more efficient farm base – maybe no more than 15 - 20 farms at some stage in the future – but this depends on market forces
- farmers are more efficient in the future, better managed and in less need of government support
- new industry entrants are required – they are more likely to enter an industry which has a sense of real purpose in it than they are in its current state – at the moment, the decision not to enter the sector is just about as easy as it could be
- there will be a small number of dairy farmers operating outside the JD structure in non competing markets
- farmers that want to exit the sector have a way out – through payments made from sale of Five Oaks – but not nearly as much as expected – and might be limited to buying up quota @ 20 p a litre – and seeing them not re issued

None of this is without risk !

If farmers and other players in the Jersey dairy value chain, not least customers both on the mainland and the Island itself, do not buy into the concept of the voluntary co-operative, then the industry might go into free fall sooner than expected. This more than anything else would make the import of liquid milk all but inevitable.

13.2 Change Mechanisms

We see the challenge as not being so much as to reduce production to what might be seen as a more optimum level. Section 8 of this document describes how “excess production” is still being incurred, which suggests that farmers on the Island should be persuaded and/or encouraged to reduce production. However, we see it very much more as a problem less of having the “*wrong volume*” of production but more of the “*wrong type of production at the wrong time*”.

¹⁰ It has been noted that the current management has made some good progress in the last 3 years in this area

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The classic dairy industry response to the situation that the JD finds itself in at the moment is to:

- specialise in certain products

.....and/or.....

- develop differential pricing for milk at various times of the years.

In reality, most dairy companies use a combination of both methods to minimise buffer milk production and match supply and demand as closely as possible. While specialisation and outsourcing of milk supply provide best-practice examples, they are not tools that the Jersey industry can easily use at the moment.

Why is this the case ?

The current import licensing system used on Jersey means that the JD is unable to either buy-in raw milk when required or sell (export) raw milk in times of surplus. Jersey's relatively isolated position along with high transport costs means that even without the current import licensing system, transporting volumes of milk to and from Jersey may not be economically feasible.

The main option open to the JD to modify its current milk intake pattern is via strong seasonal price signals to farmers that reflect the real value of milk to the factory (and ultimately the farmer in terms of product return). Making changes to milk intake through demand price signalling is a difficult – but not impossible - task.

In summary:

- the issue is less do to with the volume of production – more to do with the right type of production at the right time of the year
- it will be important to maintain production at above the level required for just the liquid milk market in the short term - not least, to give chance to prove that the JD can export to UK mainland – if it does not happen, might have to bite the bullet – and industry goes into “*contraction*” mode of thinking
- in the short term therefore, it is not desirable to cut production too much as this cuts down the options for added value products and export business, both of which are critical for the future development of the sector

- if production is dropped too much, too quickly, the sector will go in to free fall
- cutting production is yet another negative signal to send out to the industry at a time it does not need it
- as stated earlier, cutting production now means it will be difficult to recover – at the moment there are 3,200 cows on the Island – in the future maybe c.15 herds of 150 cows each could provide all that is needed
- locally – it is a very delicate situation – if demand for other Jersey crops (e. potatoes especially) grows, dairy farmers could come out of milk very easily and this would see production volume fall quickly
- one decent sized operation leaving the JMMB at the moment would see production fall by as much as 0.5 million litres – it would be possible to go from c.14 to c.13 million litres almost in one fell swoop regardless
- Jersey does not have the luxury of bringing in more cows as exists in the UK
- it is difficult for the Jersey dairy farming sector to access more land – and it is not possible to access more cows – as a result production can go up and down quite easily – at the moment, this provides no real stable platform for future development
- there is not going to be enough left over from sale of Five Oaks for a big pay out to farmers on Jersey that might see this as a way of exiting the sector – this idea should be given short thrift
- to reduce milk production, if it was eventually required, it would be necessary to consider buying up quota from farmers wishing to exit the sector and not re issuing it
- it will also be necessary, if not even more important to consider the development of A and B contracts for producers as found in the UK – to encourage production of the right milk at the right time of the year
- there are few young farmers looking to come in to the sector at the moment – it is easy to see why – and without change, they are unlikely to want to come in to the dairy industry in the future

Jersey cannot compete internationally – its all very, very fragile – the industry must change throughout to have a chance of surviving in the future.

APPENDIX I - OVERVIEW OF FARM VISITS

In addition to dairy farmers met in their role as members of committees, individual farmer interviews were conducted with approximately half the dairy farmers on the Island.

I. Objectives

The objectives of these interviews were as follows:

- to meet a representative selection of dairy farmers on a one-to-one basis on their own farms
- to enable the farmers to provide their views in as frank and open way as possible i.e. no feedback being attributed to individual farmers (other than when specifically approved)
- to find out about the farmers' individual backgrounds and their current circumstances
- to find out about the farmers' views of producing milk on the Island
- to establish the future plans of the individual farmers, independently of the future of the dairy industry on the Island i.e. retirement, successors etc
- to find out the farmers views of the current situation of the dairy industry on the Island
- to find out the farmers' views of different future scenarios for the Island's dairy industry and how the plans discussed above might be changed as a result

The views expressed below are a summary of those of the farmers interviewed. In some cases, there was a general consensus; in others, there were widely ranging views, and this is indicated as such.

2. Backgrounds and Current Circumstances

The individual backgrounds and circumstances of the milk producers on the Island vary extremely widely, even within what is a small remaining number. This means that their perspective on the dairy industry varies greatly, and that accommodating all or the vast majority of them within any changes to the industry is going to be very difficult to achieve.

3. Producing Milk on Jersey

As is usual in such discussions, there is a tendency to focus on the challenges faced, rather than the advantages of, producing milk, regardless of where farmers are located. Their knowledge, experience or perception, of producing milk elsewhere, also influences their views.

There was a general consensus on these issues, although individual producers awareness of them varied, and the degree to which they were individually affected clearly varied depending on their own circumstances.

- **Land** - relatively small amounts owned or rented on a long term basis, wide geographical distribution of land being farmed, large number of landowners, high rents (albeit lower than in the past), small fields, lack of stock proof field boundaries and water supply, and problems associated with taking on land after potatoes, particularly those harvested later in the season (for instance low yields of maize, leading to very high growing costs)
- **Cost of “imported” goods** - the high cost of goods shipped onto the Island, particularly of bulky materials such as concentrates and straw
- **“Small” island issues** - farmers cited the lack of competition for services, both those specific to agriculture, such as contracting, as well as those of the broader island economy, such as vehicle servicing, leading to higher prices

As a result of these circumstances, the vast majority of those interviewed perceived that it would not be possible to compete on a level playing field with milk producers elsewhere in the UK, or indeed in other larger milk producing countries. They also acknowledged that it would be difficult to have a processing plant which could compete with ones elsewhere, further disadvantaging them - issues such as scale and the costs of importing packaging materials were cited.

4. The Current Dairy Industry and Future Intentions

As might be expected, the farmers' views of the current dairy industry on the Island reflected many things, not least their degree of knowledge of, or involvement with, JMMB and the JD. As might be anticipated, some of the farmers with least knowledge and/or involvement tended to be more sceptical about the motives, strategy and plans of the JMMB & JD.

It was clear from the farm visits that the majority of farmers have adopted a “holding position” in the last couple of years, as they felt they have not had the necessary information on which to base significant future decisions regarding changes in milk output levels. They

believe that this has led to a slowing in the continued process of the number of producers reducing and the average milk output of those remaining increasing. Many of those interviewed also believed their motivation had declined during this period, as they expected the review of the dairy industry in 2003 to have delivered results, primarily a long term solution to the dairy, to have been delivered by now.

Some producers will exit the industry in the next few years because of age and/or lack of successors. Others will consider quitting or reducing scale due to forthcoming capital expenditure requirements, varying from milking parlours to pollution control investment (despite the grant availability to do this). Others cited that they wanted a clear indication of the future of the dairy industry before deciding whether to quit, either because they perceive that they might get a better pay out by waiting, or because they do not want to find that other producers benefit at their expense.

Other producers will consider maintaining milk output levels, but with fewer cows, which they believe they will be able to achieve if imported semen is allowed. They cited the widespread cost savings resulting from such a scenario.

Finally, some will consider expanding if a new dairy is approved as an indication of the greater confidence that this will provide them in the future. This was true even of some producers who felt that total milk output on the Island should be reduced in future.

5. Future Scenarios

5.1 The Dairy

The vast majority of those farmers interviewed felt that the future prosperity of the dairy sector on the Island was largely dependent on resolving the situation with the dairy (i.e. replacing it with a newer one).

There was a broad consensus that the current dairy is out of date and inefficient, despite an acknowledgement of significant improvements made in recent years. However, there appeared to be some confusion as to the degree of progress that had been made towards replacing it i.e. farmers interviewed had widely differing views about what was happening to the current site, where a new dairy might be built, and what capacity such a dairy might be. Many hoped that the production of this report stimulated a swift resolution to the issue, but that they have a full opportunity to put forwards their views and to influence any such decision.

The decision about which there were very significant differences in the opinion of the farmers interviewed was the potential capacity of any new dairy. A significant number of producers

had considerable reservations about building a dairy capable of handling any more than the current level of milk output on the Island. These producers were of the opinion that any new dairy should be built to meet the current liquid milk demand on the Island, and to find a use for the surplus seasonal milk and/or milk constituents at minimum cost. Several were sceptical of any plans to develop a larger new dairy based on developing significant markets for other products, either on the Island or elsewhere.

5.2 Semen Imports

While many farmers admitted to having strong or very strong views about this issue, most, when pressed, admitted that it was of secondary importance to resolving the situation with the dairy. Views on the lifting of the semen ban were expressed very forcibly both ways, in both cases by several of the farmers interviewed. Given the time available with the individual farmers, and the requirement to cover a broad range of issues affecting the future of the dairy industry on the Island, the details below provide only a flavour of the different opinions about this issue.

Amongst the arguments put forwards by the advocates of the lifting of the ban were the benefits in terms of cutting costs to produce the same quantity of milk, or of producing more milk from the same number of cows. They believed that this would enable milk production costs to be decreased, bringing them closer to production costs in other countries, providing a better opportunity for the milk produced on the Island to be more competitive, albeit still not fully so. There was also an argument put forwards by some of the farmers that the permitting of beef semen would enable income to be increased by producing higher value beef cross calves.

Amongst the arguments put forwards by the advocates of not lifting the ban were the retention of the gene pool contained within the Island breed, and of its characteristics, the fact that the Island does not need more milk, and that the lifting of the ban could result in semen imports from breeds other than the Jersey. There was also a concern that the import of any semen, of whatever breed, would lead to a reduction in the pure island Jersey cow population, so rendering the population too small to continue any worthwhile breeding improvement programme.

All that can be concluded on the basis of the farm interviews is that there are a significant number of advocates of the lifting of the ban, and a significant number who are opposed. However, most regarded it as an issue of secondary importance to resolving the situation with the dairy.

5.3 Liquid Milk Imports

There was a general consensus among the farmers interviewed that, even with a new dairy, the additional costs of producing milk on the Island, would be greater than the cost of shipping liquid milk from the mainland, meaning that island produced liquid milk could not compete on price. Most considered that there was some loyalty to Island produced milk among a significant proportion of the population of the Island, although they felt this would only be true if its retail price was the same, or very similar to, imported milk.

Therefore, in the event that the liquid milk import licensing scheme was lifted, most felt that the majority or all of the milk production on the Island would cease. Some were of the view that there might still be a place for a small number of producers able to combine the production of added value products with a tourist based attraction, for instance.

5.4 Subsidised Services

Given the focus on resolving the situation with the dairy, the subsidised services were also generally considered of much lesser importance. Therefore, it was not possible to examine the farmers views in detail, as many stated that a failure to resolve the dairy situation meant that the subsidised services might not be necessary in future, as there would be little or no dairy industry left on the Island.

Those farmers who believed that the importation on semen should be continued were generally of the view that the milk recording service was essential for all producers on the Island, in order to provide an effective form of breeding programme. If imported semen was permitted, some took the view that they would be less willing to participate in milk recording. Those favouring the importation of semen were generally keen to maintain milk recording to measure the impact.

Most agreed that the DICS will only be of value if all the significant milk producers on the Island are included. It was generally considered that some form of subsidy towards it would be necessary if this was to continue in future. A subject that was volunteered by a few of the farmers interviewed was that of farm debt; they considered that it was a crucial issue in terms of farmers' future strategy, yet one which was not included in the costings, and which was difficult to discuss on a small island.

6. Future Dairy Structure

The majority of farmers felt that, provided the current liquid licensing scheme was maintained, and the Island had a requirement to produce in excess of 10 million litres, then the future structure must be based on maintaining a significant number of producers. This is probably a minimum of at least ten, although some stated a higher number.

They felt that there would be little point in the Island continuing to have Jerseys on it if they were all on a small number of very large farms, using systems which meant that they were rarely seen. In addition, they felt that a small number of farmers would not be in the long term interests of the Island, as individuals could then significantly endanger the future security of the Island's liquid supply, thus leading to imports, and to the subsequent potential collapse of the dairy industry.

7. Summary

The dairy farms on the Island vary greatly in terms of size and milk production systems, despite facing many common challenges. Despite the major rationalisation of the industry over the years, the majority of farmers have felt in a degree of limbo during the last couple of years as they have awaited developments regarding the future structure of the dairy industry, particularly with regards to the future of the dairy. This has led to many of them putting major decisions on hold, although some have committed to significant capital expenditure on their farms during this period.

The farmers' views of how the industry should operate in future vary greatly, particularly with regards to the total amount of milk produced on the Island, and the capacity of any new dairy plant. There is a general acceptance that the benefits of the new dairy should be shared between consumers and farmers, and that a reduction in the cost of milk to consumers will make the continued licensing scheme for liquid milk imports easier to maintain. Most farmers accept that, without a continued licensing scheme for liquid milk imports, there will be no significant dairy industry on the Island, although there could still be a place for a small number of niche producers.