BTG Global Advisory

UK INSIGHT

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The state of the farming nation

In the first of a series of agriculture industry updates, BTG Global Advisory provides comment on the economic and environmental factors driving significant change in the UK farming sector.

UK farming is facing a dichotomy, the likes of which it has rarely seen. A rapidly-growing global population will present billions of hungry new mouths to feed in the next three decades, yet the political environment in which this food will be produced has arguably never been so uncertain.

Also globally, an increasingly affluent demographic is changing its diet and driving new food trends and demanding the sort of quality that British farmers can supply. A surge in consumer demand domestically and the freeing up of export markets has led to something of a perfect storm for farmers – produce what the consumer wants and you will succeed? Maybe not.

With increasing consumption comes scrutiny of the way food is produced, and farmers are feeling the political squeeze. Crop chemistry to fight pests, weeds and disease is rapidly diminishing, animal medicine licences are being reviewed, and protection of the natural environment has been ramped up on politicians' agendas.

From this dichotomy comes a mantra which has been widely adopted by UK farmers: produce more, impact less. The race is on to be the first to do it.

Does the CAP Fit?

Central to the way Europe produces its food is the Common Agricultural Policy (CAP) – rules handed down from Brussels for each EU member state to implement and govern.

For the past three years intense negotiations have taken place to set out a new CAP, which came into force in January 2015. Crucially for many UK farmers who are still reliant on EU subsidy payments, the criteria to access this financial support has changed significantly in order to place more emphasis on the environment.

Farms with between ten hectares (ha) and 30ha must now grow at least two different crops, while larger farms must grow three in a move designed to break up monoculture cropping which zaps the nutritional value of soil.

As well as addressing crop rotations, farmers must also designate 5% of their land as an Ecological Focus Area to encourage wildlife and biodiversity into farmland. Failure to comply with these new guidelines will lead to subsidy payment penalties which will hit farm cash flows hard.

Farmers are innovating to ensure that these environmental imperatives do not reduce the amount of land available to grow food on, but many have had to quickly adapt to meet the new criteria.

With Adversity Comes Opportunity

Despite the challenges facing UK agriculture, industry leaders agree that British food production has never been so high on the political agenda – thanks largely to a shift in public perception.

The generation of farmers tasked with meeting these production challenges while ensuring farm incomes rise are enjoying something of a renaissance as shoppers go local, demand British and want to know more about the farm-to-plate story.

Figures from the National Farmers' Union (NFU) suggest that more than three in four people want supermarkets to sell more food from British farms. Farming is now a popular industry to be part of and has prime-time slots on television and radio, including a whole series dedicated to the next generation.

The average age of the key farm decision-maker is still around 55, but young graduates, educated in business management, are returning to the family farm or entering the industry with fresh ideas and enthusiasm. Their familiarity with technology is also encouraging innovation in the products available to make farm businesses more efficient. Driverless tractors steered by satellites are already available, and even the most modest family farms are using GPS guidance, crop sensors and other precision farming tools in day-to-day work.

Customers of British farmers are also getting more comfortable with technology. Clicks are still some way behind bricks in the way people shop, with retailer Sainsbury's saying that more than 60% of its total grocery income is spent in the out-of-town supermarket compared to the 5% spent online. However, that online market is set to double in the next five years and convenience stores will continue to be the largest growth area for the major retailers. Basket spend tends to be smaller in the convenience format, but shopping occasions are more regular.

British food producers are catching on and developing websites and sales channels direct from the farm to ensure they take a larger share of the profits.

Where We'll Buy Our Food in 2020 (% of Total Grocery Spend)

Out-of-town supermarket	58%
Convenience stores	28%
Online	10%
Other	4%

Source: Sainsbury's / Kantar Worldpanel

And Then There's Volatility

The value that the farmer receives at their farm gate is driven by a huge variety of factors – most of which are completely out of their control.

Global weather is an obvious driver, due to its impact on production across the world, but oil prices, exchange rates, interest rates, inflation and supermarket pricing strategies all contribute. Farm businesses are now being told to plan for volatility, rather than how to deal with it when it comes along.

How Population Growth and Globalisation Will Affect Food and Farming

Global population set to rise from around 7 billion today to 9 billion by 2050.
Consumers will enjoy a more westernised diet – meat and dairy products particularly.
Competition for land, water and energy will intensify.
Agriculture will need to reduce greenhouse gas emissions and the effect of climate change will become increasingly apparent.

Source: Defra / Foresight Report

There's no better example of external factors influencing an agricultural market than in the dairy sector where a number of global issues have led to processors slashing the price paid per litre to a level that's below the cost of production for some farmers.

After a period of sustained improvement in the sector, summer 2014 saw a downward spiral of world markets and external factors, including high milk production globally and a Russian ban on imports, which exacerbated the situation in an already oversupplied marketplace.

Retailers too are using milk as a price battleground, squeezing processors and, consequently, farmers. This race to the bottom is continuing in 2015, sparking further protests from farmers angered by a drop in shop milk price which they say devalues their high-quality product.

Price volatility is leading to bank managers taking a much closer look at farm accounts. Gone are the days of the local bank's agriculture specialist turning up for a coffee and a catch up – now it's an analysis of the farm's business plan and a detailed look at the environment surrounding the enterprise.

Banks are now looking at farm accounts as a business entity – rather than a secured property lend – and land agents across the country report an increase in the number of farmers having to sell assets to clear overdrafts and improve cash flow. Debts may not be being 'called in', but pressure is being applied.

On a practical level, managing the potential for an increase in base interest rate and, therefore, overall interest payments, and knowing how that will affect the business has become one of the key calculations to ensure the level of bank borrowing is sustainable.

Farm Business Income

The key findings from the research are as follows:

- Average Farm Business Income fell on cereals, general cropping, mixed and grazing livestock farms in 2013/14 but increased on dairy, pig and poultry farms.
- For the cropping sector, the wet autumn of 2012 continued to influence profitability. Drilling was disrupted, which led to increased areas of lower yielding spring crops harvested in 2013. Crop prices were also lower due to weakening global markets.
- Average incomes fell on grazing livestock farms – both lowland and LFA (Less Favoured Area). The cold, late spring following the wet autumn of 2012 led to higher feed costs and lower output from the sheep enterprises. In the LFA, output from beef was also lower than in 2012.
- On dairy farms, the increased income was driven by a higher milk price (14% higher than in 2012/13) and increased production (8% higher than in 2012/13).

Farm Business Income			
Average £ Per Farm	**2012/13**	**2013/14**	**% Change Year-on-year**
Cereals	67,700	49,500	-27%
General cropping	89,200	67,600	-24%
Dairy	52,600	87,800	67%
Grazing livestock (Lowland)	16,100	15,100	-6%
Grazing livestock (LFA)	18,700	14,500	-22%
Specialist pigs	41,700	65,200	56%
Specialist poultry	90,200	157,200	74%
Mixed	37,300	29,500	-21%
Horticulture	25,800	33,900	31%
All types	**44,900**	**43,100**	**-4%**
Source: Defra / NFU			

Will Supermarkets Retain Their Power?

Supermarkets are, by some distance, agriculture's biggest customer, but a number of global developments may influence the dynamic of British farming in the next decade.

For some farmers, expansion is the key – larger herds of cattle or building processing and packing facilities to handle sales direct – while others choose to downsize or create niche, added-value products which command a premium.

In the fresh produce sector, investment is being made in bigger, better packing facilities to deliver 'store-ready' products direct to the retailers. But expansion is not for everyone though, especially with land commanding an average £19,000/hectare and good labour hard to come by.

China could be a golden destination for British food, particularly for red meat where statistics show potential to change significantly the way British farmers and processors handle their products. Conservative projections from the English Beef and Lamb Executive (EBLEX) show the Chinese market to be worth tens of millions of pounds. Not only would a trade deal to sell British beef and lamb into the country – which is still some years away – create a vast new market, it would largely be made up of animal products which are currently discarded in the UK, or sent for low-grade processing, such as for pet food. Chinese customers would demand feet, ears and offal, increasing the value of the whole carcass to livestock farmers when they send an animal to slaughter. Danish and British pig meat has already been granted market entry into China and processor Danish Crown now ships two containers loaded with pig meat to the country every hour. Pig ears, previously being sold for 50p, are now commanding a price closer to £3, emphasising the opportunity for growth.

Staff are being placed in the British Embassy in Beijing to help earn the trust and reputation required to break into the market, and an initial Memorandum of Understanding has already been signed by representatives of both governments to agree a shared goal. Any trade deal that can be struck will augment farming's already impressive contribution to the British economy.

Defra says that the UK's food and farming sector is worth £103bn to the economy, employing one in eight working adults in the UK.

The Role China Could Play in British Agriculture
China's 1.3bn population is still rising – more than 20 million people live in Beijing alone.
Growing wealth is leading to increased meat consumption, which has jumped 21% in 13 years.
More than 1.7 million pigs are eaten every day in China, demonstrating the growing national appetite.
New Zealand and Australia currently have export deals in place for lamb, which means British supply could dovetail in the peak lamb season of July to December.
Chinese consumers tend to want cuts not utilised in Britain, potentially offering better carcass balance at slaughter for UK processors.
Source: EBLEX

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