

# Price transparency in the milk marketing chain

Presentation to the Liquid Milk Conference  
Naas, 4 November 2009

Alan Matthews

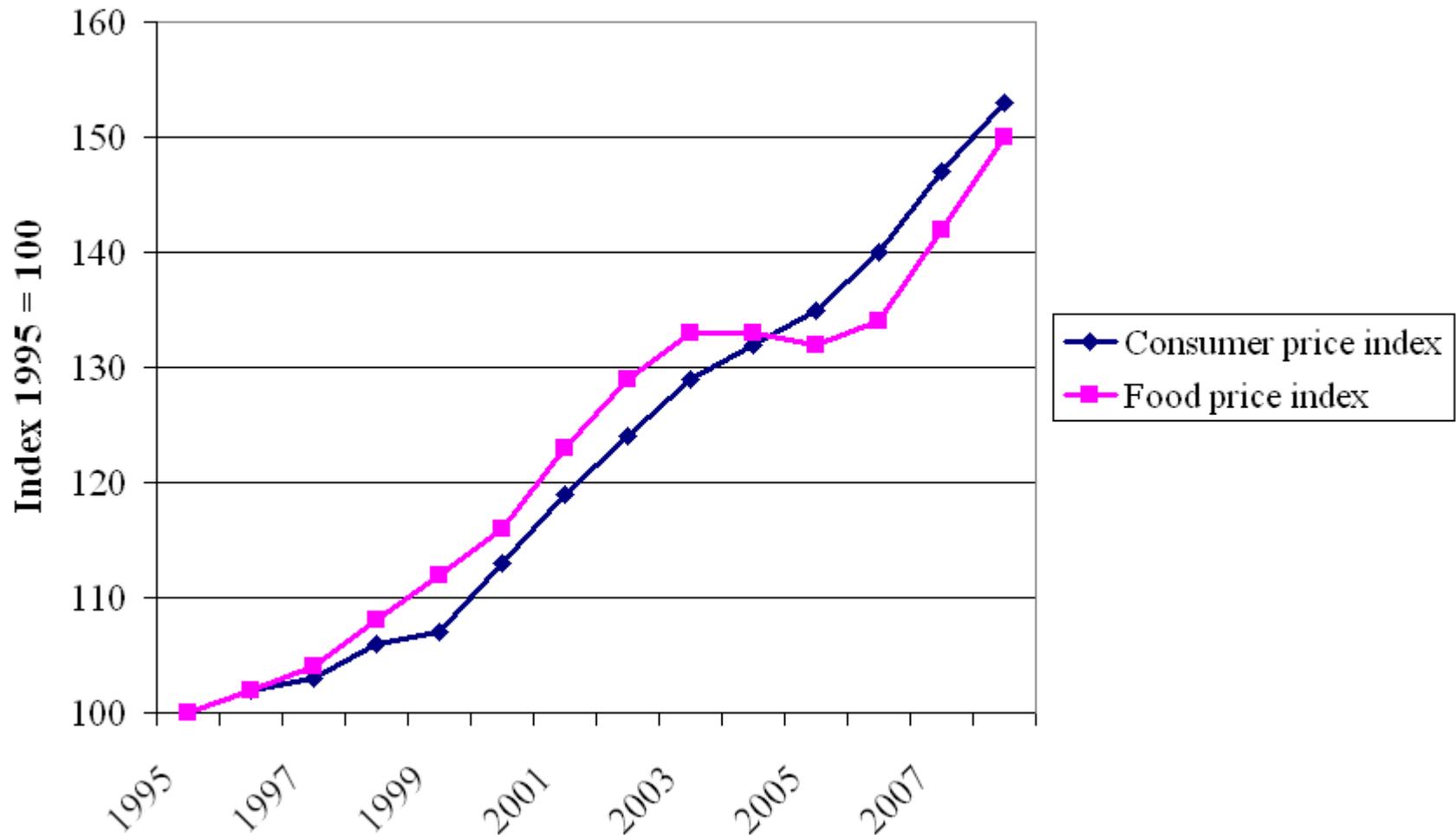
Professor of European Agricultural Policy  
Trinity College Dublin

# Presentation outline

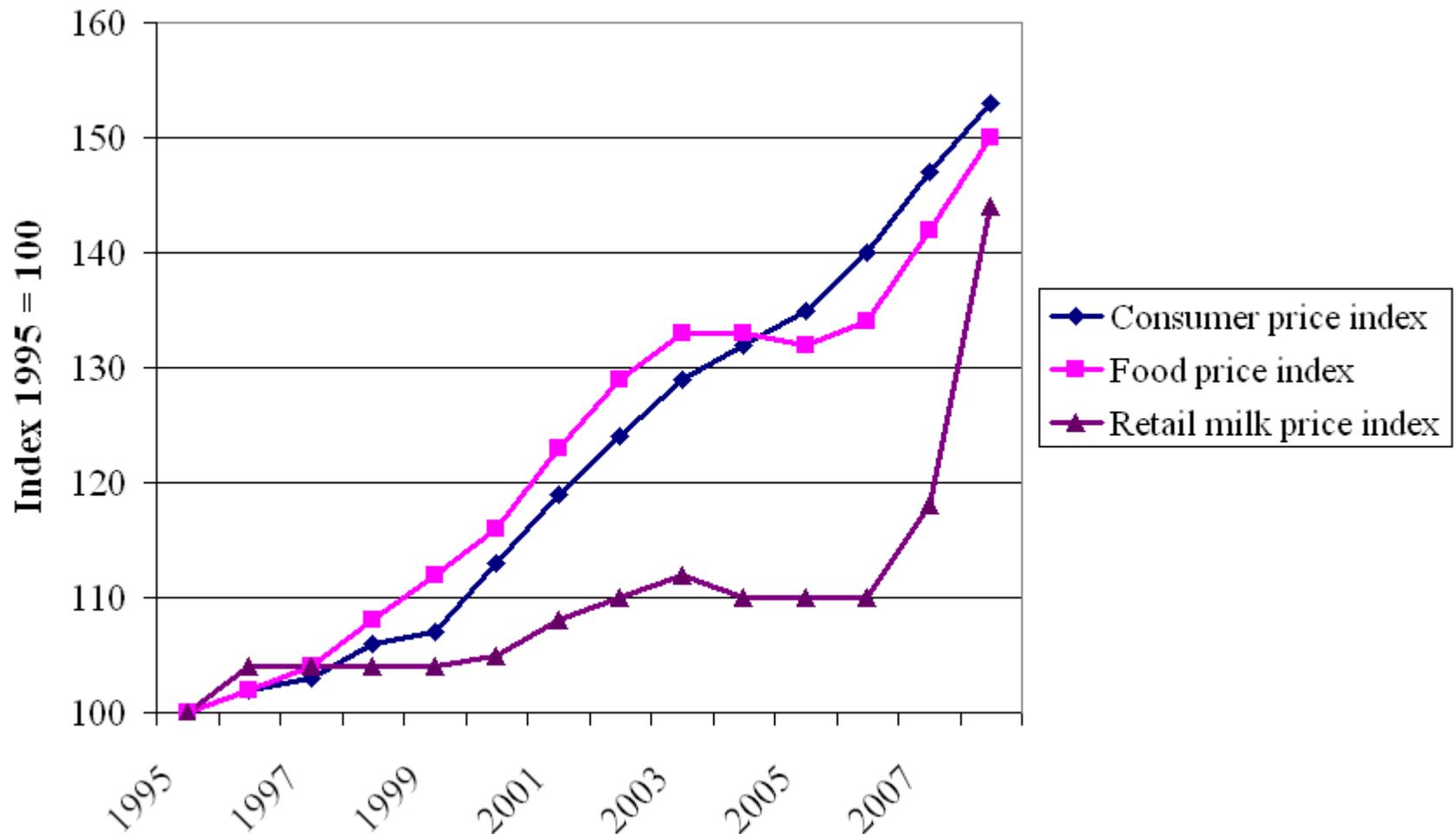
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- Trends in prices and margin shares in liquid milk
- Bargaining power in the milk supply chain
- How can market power in the milk supply chain be addressed ?

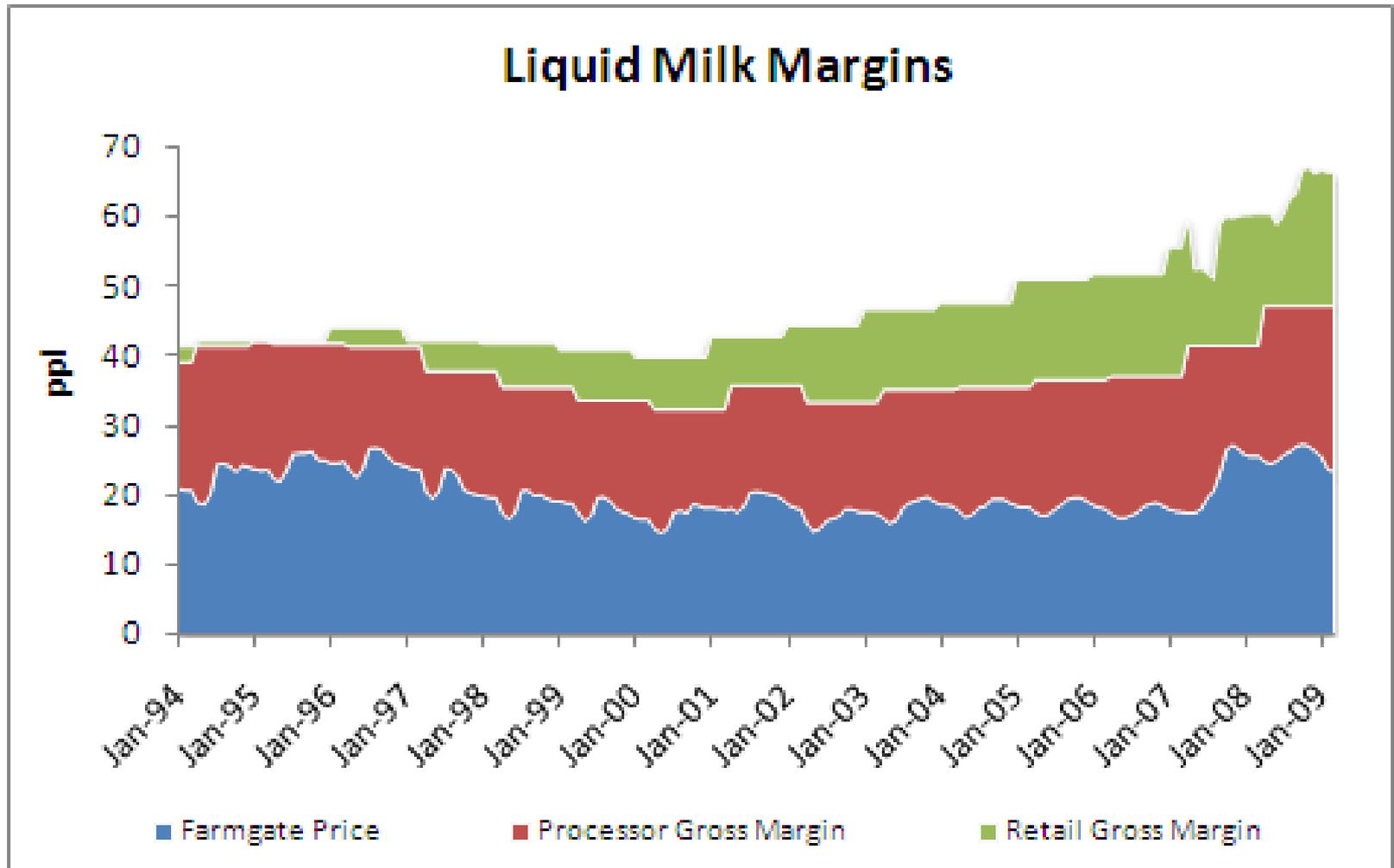
# Trends in milk prices



# Trends in milk prices



# Developments in UK margin shares



# Margin breakdown in Ireland

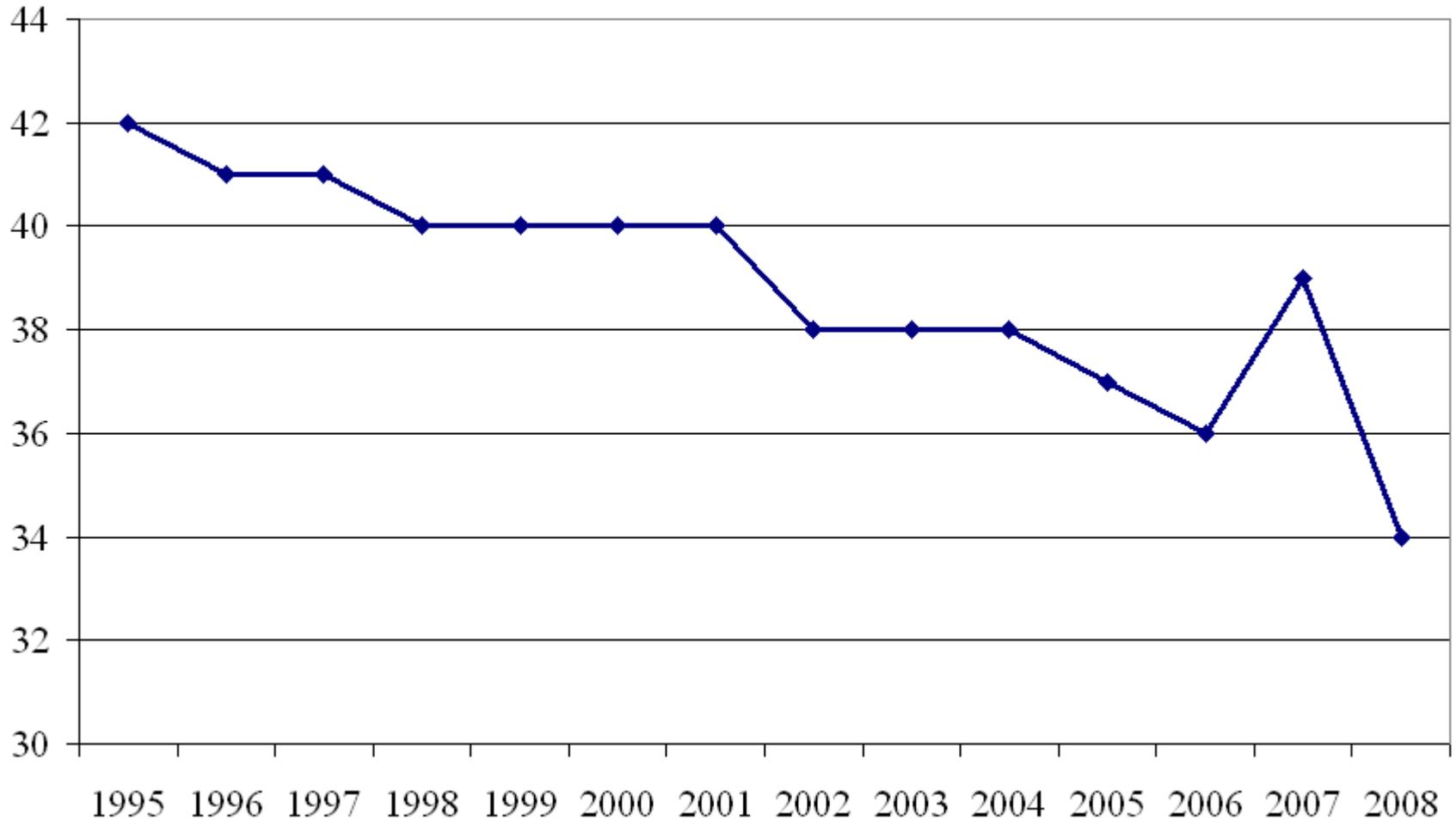


Source: IFJ 24 Oct 2009

- Unlike in the UK, there is no official series of processor prices for liquid milk sales to retailers
- Therefore no definitive statement can be made whether processors or retailers have benefited from the decline in the producer share
- National Milk Agency should publish full margin breakdown in the interests of transparency

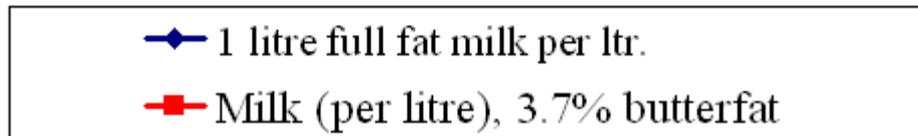
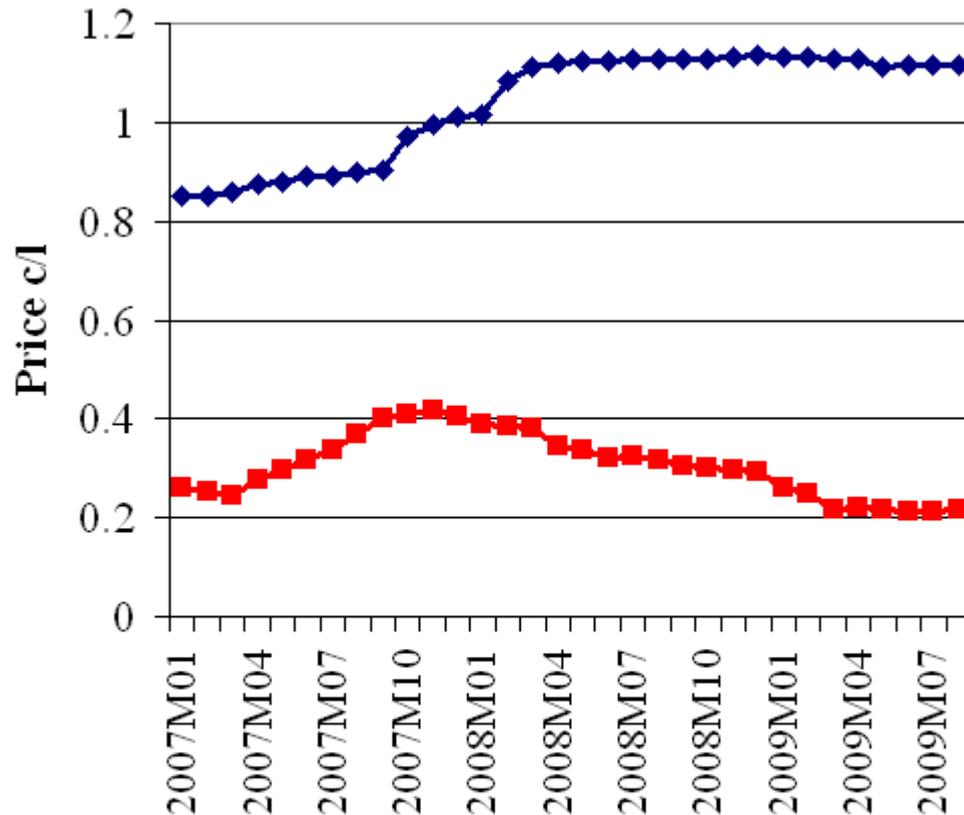
# Trend in producer margin

Per cent, %



Source: NMA

# Recent margin trends in liquid milk



Retail milk prices lagged the increase in raw milk during the price spike 2007 but have not fallen back in line with the fall in farm milk prices since Q1 2008

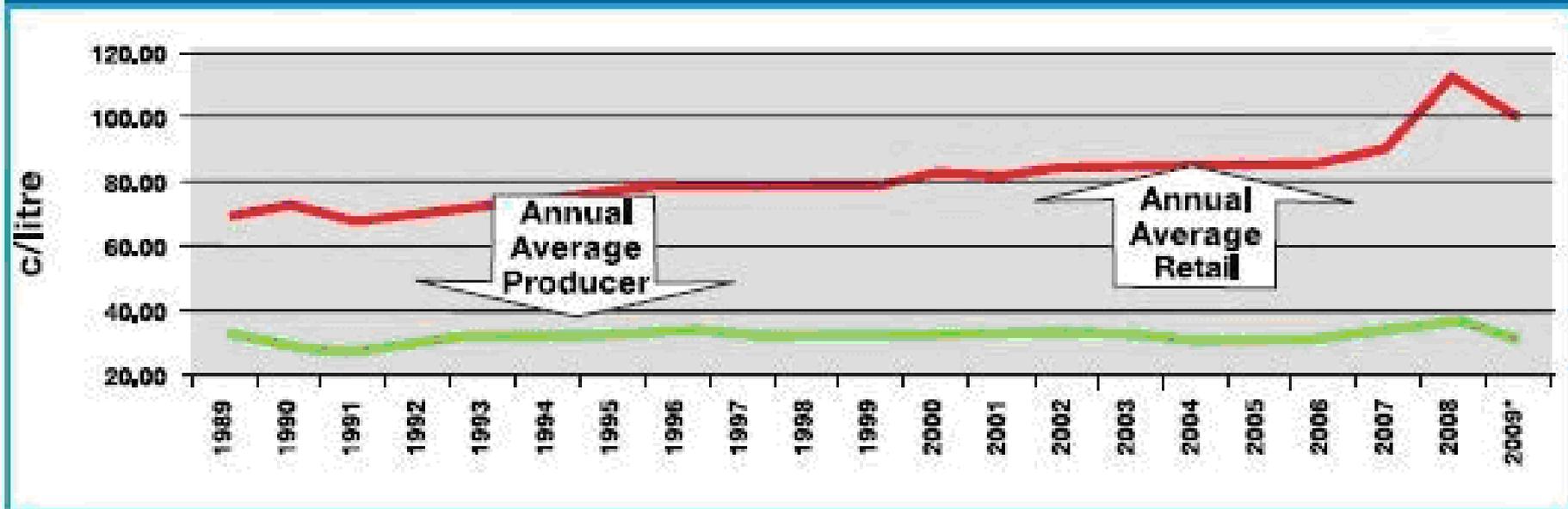
Large fall in producer share

M01 2007 30%

M08 2009 18%

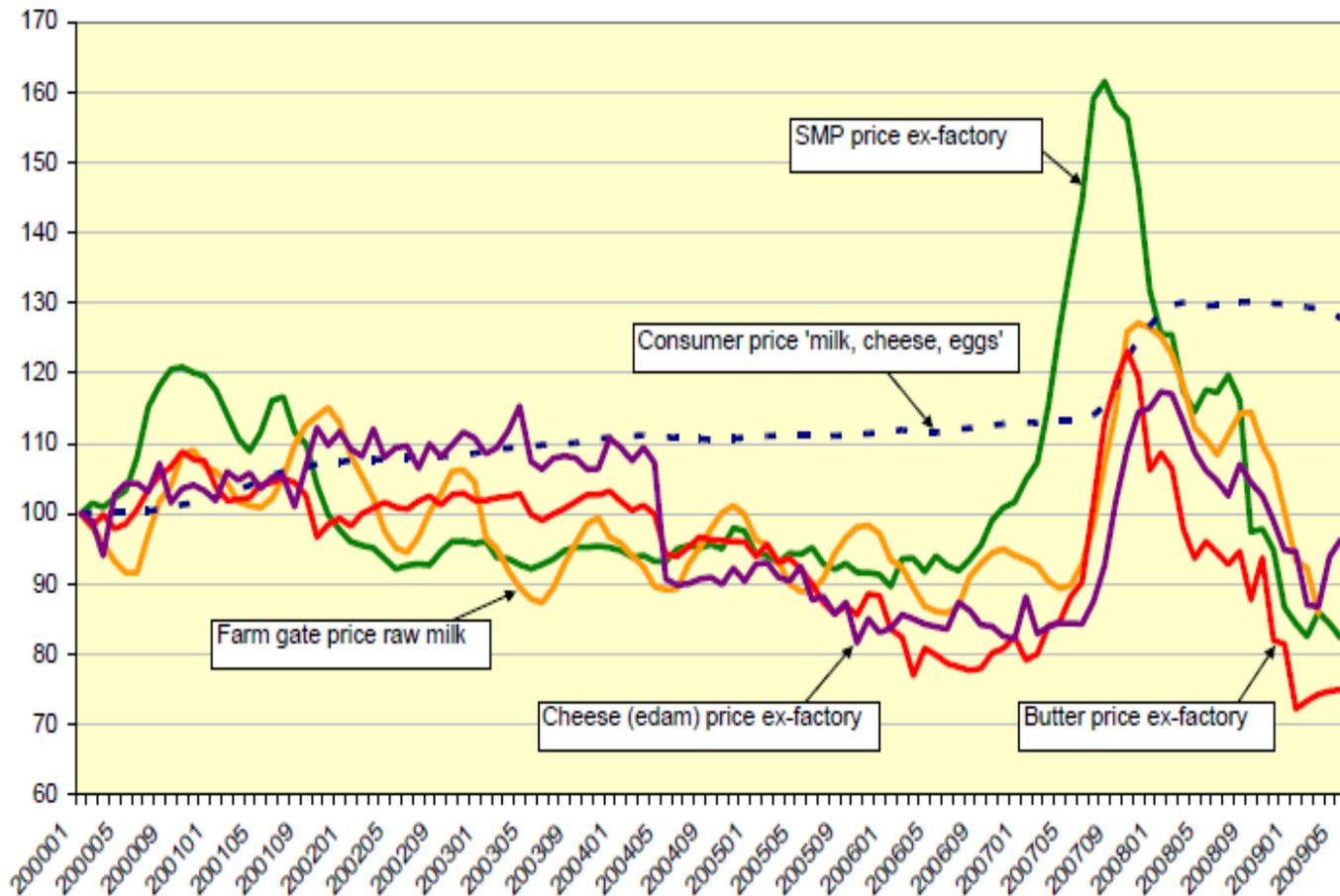
Note: Use of manufacturing milk monthly prices

# Liquid Milk Producer Price v Retail Price 1989 to 2009



Source: Fresh Milk Producers website

# Price index developments in EU dairy supply chain, Jan 2000 = 100



“The magnitude, the delay and asymmetry in the downward adjustment of dairy consumer prices - which is particularly marked in some Member States – clearly shows that the EU dairy supply chain does not function efficiently.”

# Criticisms of the liquid milk price formation process

- Liquid milk is being sold too cheaply as a commodity at retail
  - ▣ Comparison with bottled water
- Retail margin on liquid milk is too high
  - ▣ Margin on liquid milk higher than on other grocery items (Paul Mooney IFJ 8 April 2006)
- Declining producer share of retail milk price is evidence of unequal and unfair bargaining power in the dairy supply chain
- Failure to reflect recent fall in raw milk prices at retail level is further evidence of supermarket market power

# How are prices formed in the milk supply chain?

- Valuable recent UK study by Oxford University economists on the UK milk supply chain
  - ▣ Smith and Thanassoulis 2008
- The distribution of the rents in the supply chain depend on relative bargaining power of the parties
- Bargaining strength is a function of
  - ▣ Number of participants on either side of the table
  - ▣ The existence of outside options (i.e. what is the best alternative available to a party if it fails to strike a deal)

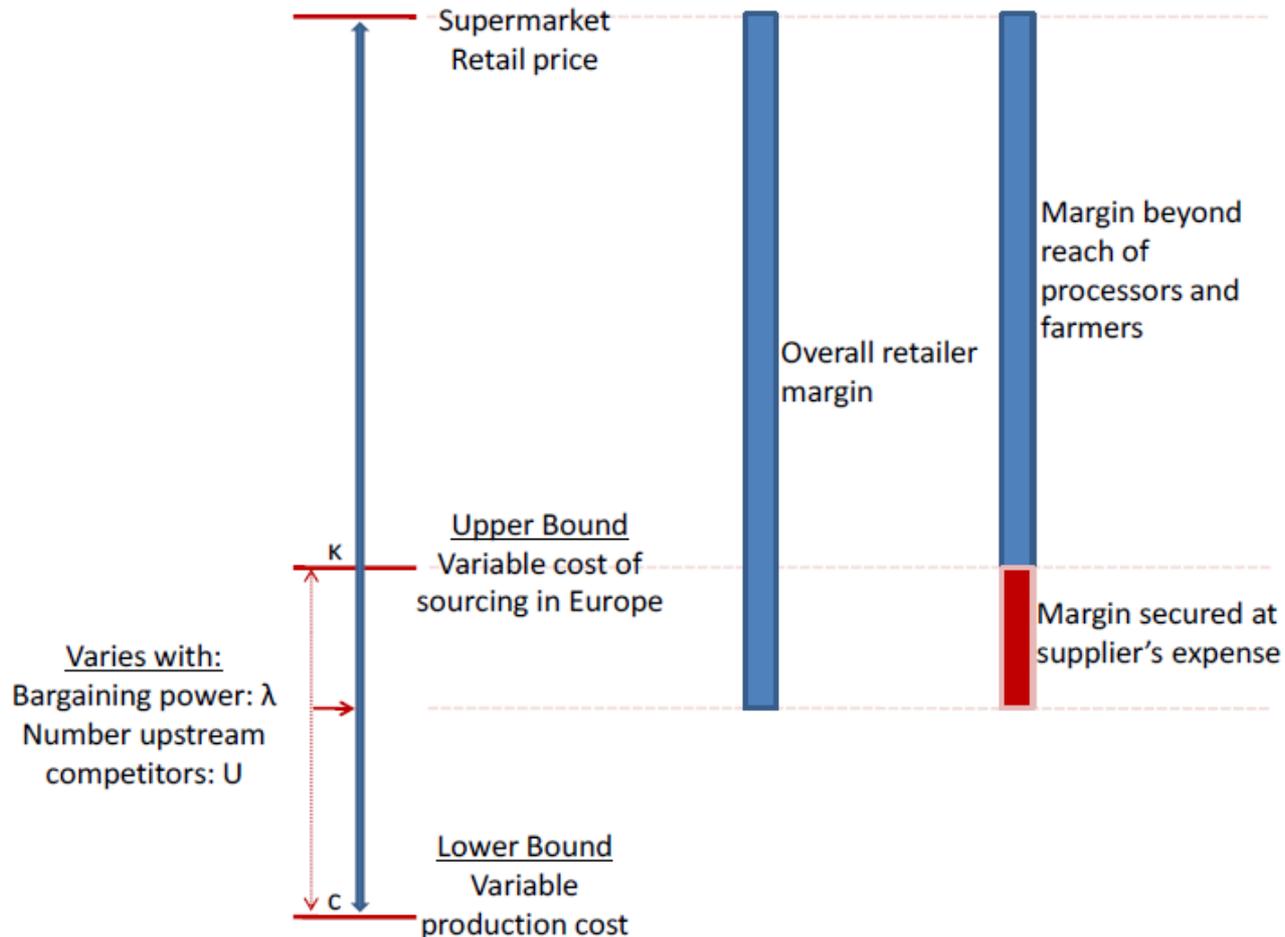
# Setting the retail milk price

- The concept of market power
  - ▣ The ability to set price above marginal cost and thus to create rents
- Retailers may be able to increase rents at the expense of consumers depending on the strength of competition in the retail market
  - ▣ Some evidence that some consumers are relatively insensitive to price of liquid milk

# Bargaining strength and outside options

- An important assumption in UK study is that consumers are either indifferent to or ignorant of the provenance of their milk
  - ▣ In the UK most milk is sold as own label, thus seen as a homogenous and undifferentiated commodity
- For supermarkets, the ultimate outside option is to source milk from imports
  - ▣ This sets the upper price that processors can expect to obtain
- For suppliers, the outside option is to produce manufacturing milk
  - ▣ This sets the lower price that processors can afford to obtain if they want to continue to attract liquid milk producers

# What processors can and cannot bargain over – UK case study

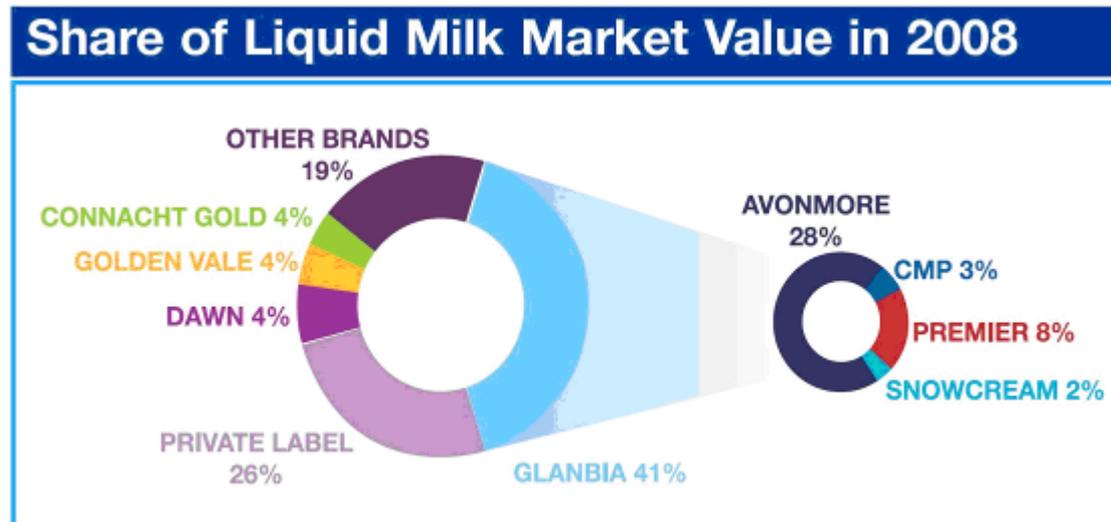


# Implications for the Irish situation (1)

- How much rent can supermarkets extract from consumers?
  - ▣ Level of competition in Irish market increased with the entry of the discounters around 2000
  - ▣ Supermarkets kept prices down to attract sales from direct deliveries
  - ▣ High level of branded sales despite price premium suggests degree of price insensitivity among consumers
  - ▣ Supermarkets may use liquid milk as a loss leader as part of a retail strategy (but not consistent with evidence that liquid milk margins are higher than average grocery margin)
  - ▣ More recently, competition from cross-border shopping may limit market power of multiples vis a vis consumers

# Implications for the Irish situation (2)

- Relatively few purchasers of liquid milk
  - ▣ Three largest multiples have 70% share of market
- But processors also highly concentrated
  - ▣ ... but one processor has over 50% of the market
  - ▣ Two processors control 75% of liquid milk supplies (NMA)
  - ▣ Sales of branded milk still two-thirds of the total



*MAT (AC Nielsen in December 2008)*

**Source: Fresh Milk Producers website**

# The role of imports

- Crucial difference in the Irish situation is that Northern Ireland imports are available more **cheaply** than milk from Irish liquid milk producers... and even milk for manufacturing
- Have increased from 0 to 21% over past 12 years
- This gives multiples huge bargaining power over processors and producers
- The striking feature of the Irish milk supply chain is not that the producer margin has been falling, but that it remains so high

# Price determination in the Irish market

- If all Irish retail milk sales were own label, market power of processors would be much less
- The economics of imports depends critically on the euro-sterling exchange rate

# The sterling/euro exchange rate



Source: ECB

# Conclusions (1)

- Fall in the producer share of the retail price is not unique to Ireland, but has occurred in many European countries
- Commission has asked High Level Expert Group on Milk to look at price formation issues in the milk supply chain
  - ▣ Is there a need for formalised contracts between dairy producers and processors to cover the supply of raw milk and do they help to reduce volatility?
  - ▣ Should they be obligatory for all deliveries or be the choice of both parties?
  - ▣ How can the bargaining power of farmers be increased and what role will farmer organisations play in this context?
  - ▣ Due to report June 2010

# Conclusions (2)

- Little evidence in Ireland that multiples' market power is due to concentrated buying power...
- ..rather it reflects the availability of a low-priced outside option, to import cheaper milk from Northern Ireland
- Proposals to address retail power (Grocery Ombudsman, Groceries Order) unlikely to make any real difference
- Need to connect producers with local consumers to retain the premium for locally-produced milk