The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

RURAL AFFAIRS, CLIMATE CHANGE AND ENVIRONMENT COMMITTEE

Thursday 28 May 2015

Session 4

Thursday 28 May 2015

CONTENTS

RURAL AFFAIRS, CLIMATE CHANGE AND ENVIRONMENT COMMITTEE
19th Meeting 2015, Session 4

CONVENER

*Rob Gibson (Caithness, Sutherland and Ross) (SNP)

DEPUTY CONVENER

*Graeme Dey (Angus South) (SNP)

COMMITTEE MEMBERS

*Claudia Beamish (South Scotland) (Lab)
*Sarah Boyack (Lothian) (Lab)
*Alex Fergusson (Galloway and West Dumfries) (Con)
Jim Hume (South Scotland) (LD)
*Angus MacDonald (Falkirk East) (SNP)
*Michael Russell (Argyll and Bute) (SNP)
*Dave Thompson (Skye, Lochaber and Badenoch) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Jim Baird (First Milk)
Mike Gallacher (First Milk)
Alison McInnes (North East Scotland) (LD) (Committee Substitute)

CLERK TO THE COMMITTEE

Lynn Tullis

LOCATION

The Sir Alexander Fleming Room (CR3)

Scottish Parliament

Rural Affairs, Climate Change and Environment Committee

Thursday 28 May 2015

[The Convener opened the meeting at 09:33]

Decision on Taking Business in Private

The Convener (Rob Gibson): Good morning and welcome to the 19th meeting in 2015 of the Rural Affairs, Climate Change and Environment Committee. I remind those around the table and in the public gallery to switch off mobile phones because, even in silent mode, they can interfere with the broadcasting system. You will notice some committee members using tablets during the meeting. That is because we provide meeting papers in digital format.

We have received apologies from Jim Hume and welcome Alison McInnes to the committee in his place.

Agenda item 1 is consideration of whether to take item 3 in private. Is that agreed?

Members *indicated agreement.*

First Milk

09:34

The Convener: Agenda item 2 is about First Milk. We will take oral evidence on the impact of the First Milk turnaround plan that was announced on 1 May 2015. I welcome our witnesses: Mike Gallacher, the chief executive of First Milk, and Jim Baird, the Scottish director of First Milk.

I ask the witnesses, particularly Mike Gallacher, to give us an idea of what you found when you took over the company. What was the state of affairs? What was your prognosis at that time?

Mike Gallacher (First Milk): Good morning. I have been in the role for about eight weeks, and the first few weeks have been spent in making a rapid assessment of the state of the business. I am new to the dairy category, and the first thing that struck me was how difficult the category is. I have been an outside observer working in different parts of business.

The dairy sector is clearly going through a perfect storm because a number of factors have hit it at the same time. You will be more familiar with them than I am. The situation in Russia, the situation in China, the global prices and the lifting of the quotas, let alone some of the retail pressures in the United Kingdom, have resulted in significant pressure across the board in dairy businesses. It is evident that that is having an impact. We have seen the impact on the profitability of some companies, and we have seen the consolidation that is going on in the industry to deal with those pressures. The first thing that stuck me was how difficult the competitive environment is.

First Milk is a business that has had a turbulent recent period—it has struggled financially and it has struggled to deliver a good price to its members, which is unacceptable. On the elements of strategy and focus, I have made it very clear that we need to focus back on our core business. I saw that a lot of time had been spent on other, smaller, parts of the business, and there were some costs that we needed to attack and deal with. Sadly, that will have an impact on people. In order to deliver a decent price to our members, we have to keep our costs under control.

That was the series of issues that I found when I joined the company, and there was an absolute imperative to move very fast. I have been in this situation before and I know that we have to move fast. There is not a lot of time and we have to make progress.

The Convener: You refer to the smaller parts of the business. What do those include?

Mike Gallacher: The business had a strategy of getting into areas that are more premium, which is a very sound and common direction. When a company is in a tough, commoditised and highly competitive core business, a very sound direction to take is into areas where the company can make a bit more money, particularly if they are high-growth, high-margin areas.

First Milk had taken some steps in that direction with a number of businesses, but those businesses were not yet delivering. They were not yet accretive to the financial performance of the business; they were dilutive. One example is a business called CNP Professional—a sports nutrition business—which does not take milk from First Milk, although some of its raw materials are related to milk.

The Convener: I see. You also commented on costs. I think that we should explore some of those in detail.

Graeme Dey (Angus South) (SNP): Under the plan to take the business forward, your members, the rank-and-file farmers, are very much feeling the pain. What other steps have been taken to reduce overheads across the business? I am thinking of areas such as directors' remunerations and central staffing.

Mike Gallacher: Some action had been taken prior to my arrival—I would not say that there had been no focus on that. Some difficult choices had already been made in the business. As a board, we looked at the situation when I arrived, and the reality is that we have to maintain a certain overhead structure. Because the business has changed in size, and because costs have developed, that has to be addressed. At the moment, we are looking at it across the board and there are elements of the process, such as who will be impacted directly, that are confidential. We are still finishing the consultation programme, but the impact will be widespread across different levels of the business.

Graeme Dey: Will that include the director level?

Mike Gallacher: Yes.

Graeme Dey: Do you have plans to reduce the number of directors or their remunerations?

Mike Gallacher: I think that I have answered that question as far as I can in saying that the impact will hit every level of the business.

Sarah Boyack (Lothian) (Lab): Good morning. We have read a briefing paper on the industry and we carried out our milk inquiry a couple of months ago. A key issue that keeps coming up is milk prices, and it is striking how low First Milk is in the rankings of prices paid to producers. What is your general comment on that? What scope is there for upping that price? It is a very competitive market and we spent a lot of time discussing how people could reduce costs at the producer end. However, being right at the bottom of those rankings is a huge issue for people.

Mike Gallacher: The first question that I got from our farmer members is, "Why is our milk price where it is?" I have been round the country and have talked to 600 farmers, face to face, in the past two weeks, and I have shared my conclusions on that. I have just given you some idea why: there are cost issues, there have been some performance issues in the business and, as I have said, some subsidiaries have not been delivering. There is a basket of issues.

It is fair to say that, going back, that has not always been the case. Some of our contracts pay prices in the upper quartile—you will see that some contracts pay better. Nevertheless, I am not happy about where we are and we need to do a better job.

Jim Baird (First Milk): Traditionally, part of the business model was based on brokering to predominantly liquid players. However, that part of the business has declined, particularly in the past 12 to 18 months, which has left us exposed to the commodity markets and we have had to send a lot of milk down to our drying plant at Westbury. That situation has been exacerbated by the fact that a lot more milk has been produced in the past 12 months, which is why there is such a supply and demand imbalance. We are more exposed to the commodity end of the market than other players in the UK and, to some extent, we find ourselves balancing almost the whole UK market. That is not where we want to be, given where the commodity market is at the moment.

The Convener: Are you talking about milk from Scotland going to Westbury?

Jim Baird: There is an excess of milk in Scotland, which does not go directly to Westbury but is shuttled down the country. There is a net cost to the transport and a net migration of milk down the country.

Sarah Boyack: Our inquiry considered local demand and what opportunities there are to increase local demand in Scotland. You say that we are producing too much milk, but we discussed issues related to milk products, not just liquid milk. What is the scope for doing more? Everyone mentioned yoghurt as a product that we are not producing enough of in Scotland, but there are also butter and cheese. What are the opportunities for a company such as First Milk to get into those markets?

Mike Gallacher: You were talking about getting the milk price up, and I will just finish that point. As I have gone round and spoken to large groups of farmers, I have been able to explain the impact of our cost reductions and the direct correlation with the milk price. I am able to quantify that. Similarly, with other changes in the business, we are able to say, “This is worth 0.4p. That is worth 0.2p,” and so on, and we are working to deliver those changes as fast as possible.

The other half of the equation is adding value to milk, which is a big focus. There are lots of ways of doing that within the mix of products that we deliver, whether in cheese, soft cheese, yoghurts or soft milk products. Getting that mix is part of both balancing risk and maximising returns in the business. There are international opportunities and there are opportunities for brands.

The board has kicked off a review of our strategy. When we started on the turnaround plan, we also decided that we needed to review our strategy. The strategy review process is a bit less than halfway through and will be concluded in the coming months. In time, as we complete our turnaround and cost reduction programme, we will be ready to validate our strategy. That work is on-going.

Michael Russell (Argyll and Bute) (SNP): I want to focus on the situation in Bute, because that is particularly serious. First, however, I return to the point that Graeme Dey raised with you about overall costs in the business. You said that you are looking at the overall costs of the board and directorships but that that is a confidential matter.

Mike Gallacher: In as far as it impacts on individual people, it is. We are looking at how we can reduce the cost of the board, whether through remuneration or the number of board members. We are looking at every aspect of the business.

09:45

Michael Russell: I have in front of me Jim Paice’s declaration of interest in the House of Commons from March 2015. It shows that he gets paid between £85,000 and £90,000 a year to chair the company. Given the company’s difficulties over the past year, is that fair remuneration?

Mike Gallacher: You are asking me to comment on the remuneration of the chairman of my board. I do not know what you expect me to say.

Michael Russell: I am simply making the point that that remuneration is on the public record. It is a matter of concern to some of your members, who have raised it with me.

Mike Gallacher: Absolutely. The co-op is a democratic organisation, and that salary is agreed democratically within the structures of the organisation and is externally validated. I do not know what else we can say.

Michael Russell: I want to support First Milk to succeed. You have come in as a new broom. That was very much required, but new brooms sometimes have to clear out things that need to be cleared. We will come to prices later. When individual farmers are getting less than the chairman for a month’s work of producing milk, to be blunt, they find that difficult to understand.

Graeme Dey: This may seem a simplistic question, but I want to get a handle on what is happening. You have a plan, and I presume that you have conversations with your members in which you tell them where you think you might be in six or 12 months’ time, or in two years. In hard figures, what sort of milk price do you envisage the company paying six months or a year from now?

Mike Gallacher: I have been showing members where I see opportunities and how those equate to the milk price—how, if we reduce the costs of the business by X, that equates to a certain amount added to the average price per litre. However, it would be foolish of me to sit here and comment on where I expect milk prices to be in six months. Every day, I get updates on what is happening around the world. The update that I saw yesterday ranged from New Zealand to Ireland, with people making announcements about milk prices in the region of 19.5p. Those are big dairy organisations. I cannot forecast where the market will go, so it would be foolish of me to say what the price will be in six months.

Graeme Dey: I asked the question because I am sure that your members are asking it. Some of them are faced with going out of business and they are having to make tough decisions about whether to remain in the sector. What hope can you offer them that things will be better in six months or a year?

Jim Baird: I can speak only as a farmer who is in exactly that position. What we are getting for milk at the moment does not cover the cost of production for the vast majority of producers. We cannot sit here and say what the milk price will be; we are in a very volatile period for the dairy industry, as was predicted. I do not think any of us believed that it would be as volatile as it has been but, unfortunately, that is the new reality of the world we live in. As producers, we all have to look again at our businesses and see where can shave costs. Obviously, we cannot shave them to the extent that previous milk prices come back, but that is the reality. Some of us will have to decide where the future is in dairy, and that is a valid question for us all to ask. We cannot say that the milk price will be 25p in six months’ time.

Mike Gallacher: It strikes me, as someone who is new to the category, and from conversations and frank discussions that I have had over the past two weeks around the country with 600 farmers both in large meetings and one to one, that there is an awareness that the issue is cyclical. This is our third cycle since 2007. It is deeper and higher—the gap is bigger than it was last time—but the situation will get better. That is what I am hearing from farmers. They are saying, “Mike, this is going to get better.” However, if you look at the best forecasts around the world, you will see a consistent message that there is significant uncertainty in the medium term.

Alex Fergusson (Galloway and West Dumfries) (Con): Since April, you have changed your range of contracts and you now operate an A and B pricing structure. Can you explain how that operates and say what constitutes being in the A price and the B price? Is there likely to be much movement between them?

Jim Baird: We based the A and B prices on the past two years’ production—a producer’s A volume was 80 per cent of their past two years’ production. The idea is that the A price will be on a steadier and more predictable plane and the B price will be determined more by what we get from the commodity markets. There is no question but that we ran into difficulties last year because we were not responsive enough to the market. The market ran away from us and we never caught up. The A and B prices give us some levers that we can play with.

Producers are given an A price for 80 per cent of their milk and they can produce to that level—if they do not fancy producing B litres at whatever the B price is, that is fine. The B price could go higher than the A price, which would send a strong market signal to the sector that it might want to produce a lot of milk if it could. The pricing structure gives us a bit more flexibility than we have previously had.

Alex Fergusson: Just for absolute clarity, is the 80 per cent figure fixed?

Jim Baird: It is not fixed, but it will move on a smoother plane than the B price. We set the A price ahead, so it is fixed in that regard.

Alex Fergusson: Sorry—I did not mean the price that you are paying; I meant the 80 per cent for which the A price is paid.

Jim Baird: Yes, that is fixed on an annual basis, using a rolling two-year production figure.

Alex Fergusson: Thank you. That is what I wanted to know.

Michael Russell: Somehow, a way must be found to ensure that people such as Jim Baird who are producing milk are able to do so. It is not sustainable to produce a product, even in the medium term, without recovering the cost of production. That is the reality.

It is important for members of the committee to understand what that means precisely. I have in front of me two milk invoices from First Milk, one from April 2014 and one from April 2015. They are both from the same producer in Bute. In April 2014, that producer received £15,017.23 for 46,139 litres. This year, for a slightly smaller volume—44,583 litres—the same producer received just over £7,000, after retention. More than half of that income had gone. Last year, the retention—which, the witnesses will agree, is defined as the money that the company holds on to for whatever reason—was £145.94 from an income of £15,000. The retention this year, from that much lower income, was £1,190.

I am not criticising those figures, although they are horrific. The question is, how do people survive in those circumstances? The cost of production must be higher than the A price, which was 15.576p per litre—the B price was 11.176p per litre. Even with the best producers and in the best circumstances—and bearing in mind that the cost of production will be higher on an island—the cost of production must be a minimum of 23p or 24p. Do you agree?

Jim Baird: It would be in that ball park.

Michael Russell: We have an identifiable farm on Bute that is losing that amount of money, month after month. I have another constituent who is losing £200 each day at present. That is not sustainable. Frankly, does the company expect to have suppliers in the Scottish milk fields if that situation is sustained for more than the next few months? What is your projection for that?

Jim Baird: It is not just a Scottish problem—

Michael Russell: I am not saying that it is, but it is a reality.

Jim Baird: It is a national problem right across the UK. I have had discussions with bank managers recently—as we all have to do, because we will all need support through this, without question. As one of them put it, a farmer always needs to make another investment in the business. That is predicated on whether the farmer thinks that there will be an upturn in the market in the future. It is also predicated on the family situation and whether there is succession. All those things have to come in to play. I agree that the current situation is not sustainable.

Michael Russell: The question that I would like Mike Gallacher to answer is this: what do you believe is sustainable? How many suppliers would you expect to have if this situation continues?

Mike Gallacher: There is an existential threat for dairy in the United Kingdom if this situation continues. Not only we but all the producers will find that our farmers cannot sustain themselves. Clearly, there is a significant issue. A bit away from that, we also work regularly on contingency plans in relation to our volumes and how changes would affect our business.

You have stated the problem clearly: that is exactly the problem that we are dealing with. That is why, to the extent that there are things within our control that we can do, we need to move fast. It is also why we need to work effectively together with all agencies, Government, local government and businesses to find the best solutions possible.

The Convener: You spoke to 600 farmers. How many of them were in Bute, Arran, Kintyre and Gigha?

Mike Gallacher: I have had meetings across the country—the midlands, Wales, Cumbria and central Scotland. In the past two weeks, I have had meetings in Kintyre and Bute, with pretty much 100 per cent attendance by the farmers and with people from other agencies, such as NFU Scotland. Those meetings have been productive. They have not been about good news—I have been sharing stuff about the business that we are not happy with. However, the focus is on what we are going to do as a business and what we are going to do together, as a co-operative, to get into a better position.

Angus MacDonald (Falkirk East) (SNP): On the price issue, you mentioned earlier that, from New Zealand to Ireland, the price was sitting at around 19.5p. I am curious about whether there is any prospect of a European Union intervention price being introduced, albeit temporarily. Have you lobbied the Department for Environment, Food and Rural Affairs on the point recently?

Mike Gallacher: As I said earlier, I am eight weeks into this job, so my knowledge of the dairy industry is not as great as any of yours. I understand that there is an EU intervention floor price and that we are getting close to that level.

Angus MacDonald: Is there any prospect of that intervention price being increased, albeit temporarily?

Mike Gallacher: Not that I am aware of.

Claudia Beamish (South Scotland) (Lab): I am a member of the Co-operative Party and I am in the parliamentary group of Co-operative members. I would like to ask you about the significance of the fact that First Milk is a co-operative. What are the strengths of that?

I would also like to ask about engagement. We recently took evidence on the strength of producer organisations in the dairy industry. I do not want to put words into your mouths, but do you see the fact that First Milk is a co-operative as a strength? What other strengths do you see?

Mike Gallacher: One of the reasons why I took my present role is that I saw the fact that First Milk is a co-operative as a potential strength. Empirically, that is not always the case. In the UK recently, a number of co-ops have struggled with being successful businesses as well as successful co-operatives. However, for me, benefits include the fact that it is a democratic organisation. It is owned by the members, and members have a stake in the organisation and set its strategy. There are, potentially, some great strengths.

We have announced that we are reviewing how we have done business in the past couple of years, and we have talked about the Myners review of what happened in the Co-operative Group. We share a view that there are some lessons that we can learn about how to run a co-operative better in order to deliver a better result for members.

Jim Baird: I have been a stalwart of co-operation all my days, but there is no doubt that co-operatives face a challenge. We fall prey to commercial organisations that want to cherry pick our best producers.

Ultimately, a co-operative has to be as commercially driven as any other business. However, to be honest, that is sometimes not the easiest thing to do because we find that, as producers, there is a natural instinct for us to be more socially aware perhaps than some of the commercial organisations, which can leave us at a disadvantage.

10:00

Claudia Beamish: Do you see that social awareness as a strength or as giving you clout in relation to negotiating prices and so on?

Jim Baird: It can be a good story and there can sometimes be an advantage in going with it but, traditionally, the retailers have maybe not been good enough at shouting about it or valuing the story in terms of paying a premium for it.

Michael Russell: Surely one of the strengths of a co-operative is equity of treatment for all the members of the co-operative. I can understand that there are real pressures on price—nobody is disputing that—and, in a sense, I understand and support some of the efforts that you are making to turn the business around. However, Mike Gallacher knows what my sticking point is, because we had a conversation about it this very morning before the meeting. In case anybody saw us talking, I should say that there was nothing secret about that meeting.

My sticking point is that I am concerned about the lack of equity of treatment of the 13 producers on Bute, who are receiving 1p a litre less as a result of the turnaround plan, which seems to be against the principles of the co-operative. A lot of good work has been done by a lot of people, including the company, the farmers, the Bute estate, the Scottish Government and others, to get a new dispensation for transportation for the next six months. Essentially, that will reduce the price difference to about 3p. Would it not be in the spirit of the co-operative if it accepted that the 1p cut should now disappear before implementation so that there was equity of treatment at least across Kintyre and Bute?

Mike Gallacher: You made a couple of points there. Of course, I am new to this role and to working in a co-operative organisation, but what is very clear—maybe there is a misconception about this—is that this co-operative has for years had different prices for different groups of farmers and those prices have been based, to a greater or lesser extent, on the value of the milk.

As I have got into my role, I have sought advice and have understood from others who have expertise in the co-operative field that it is not an established principle across the world that everybody should get the same price regardless of the commercial value of what they are producing, so I do not accept the principle that they should.

However, I do accept the principle of consistency of treatment. A large number of farmers were adversely affected by our announcements about the new milk fields, so it was important that we applied some consistent principles across the organisation. We did that because it was the right thing to do and because we are accountable to our farmers for their consistency of treatment. That is why it is important that the farmers on Bute are treated consistently with the 337 farmers in the midlands—we talked about this earlier this morning—who received the same impact from the changes.

As I have gone around talking to farmers across the country, I have stressed that, in changing the way in which we set prices to something that is based on value, farmers have a line of sight to either the creamery or the customer and can therefore—in my view—be more involved and engaged and hold people to account for their performance. However, as we make that change across the country, there will be some volatility in the prices. When we announce the change, the impact is that some prices go down. Given that there is some volatility in the market, next month and the following month some of those prices could go up and down. Therefore, to the extent that some farmers have had a 0.2 per cent increase and some have had a 1 per cent decline, I note that those are monthly numbers that will change.

On our discussion this morning and your point that the focus should be about what we are going to do to help farmers, there might be some implications from the volatility, because farmers need to be able to deal with it as that is their life now. Does that mean hedging? Does it mean giving better financial advice about how they manage their businesses? That is certainly on our agenda in terms of how we can help them.

Jim Baird: If we are going to continue down the route that we have chosen, the requirement for transparency is key. I know that you guys have previously been critical of us as a business on that issue, but transparency is an absolute must now. As Mike Gallacher said, if we are going to pay people different prices, we have to be accountable for how that is worked out.

I have been chairing a working group in Kintyre. At our last meeting, we put up the profit and loss statement for the creamery and it was absolutely clear to the farmers what would drive a price for them and the issues that they need to address. It is all about getting buy-in. We have been perfectly up front with the guys in Bute about the cost of the haulage, and we have put it out there as a target.

Michael Russell: Haulage costs can be reduced; that has been demonstrated. The Government and the Bute estate have put in resource to support the cost of haulage. I am keen to support the company in recovery, but the sticking point for me is the unfairness in Bute. It seems to me that you are asking your members in Bute to pay the same to be members of the co-op—their retention has not been reduced by any percentage—but what they get out of that is the lowest of what anybody in the co-op gets out of it. That is unfair and inequitable. We have talked about the risk of going out of business, and those farmers stand an even bigger risk because that situation exacerbates their problem.

We are not going to agree on this, but I will make the point again because it is important. Given that the 1p difference has been substantially bridged by actions that have been taken by the Scottish Government, the estate and others, and that there is still potential for the company to save on haulage, the company's intention to create an equity with Kintyre—nobody is asking you to do anything else—would be tremendously valuable in terms of good will towards the company in the future.

Mike Gallacher: As we have discussed this before, we absolutely understand the strength of your view. We, as a board, have a strong view that we need to treat all our farmers across the country consistently. If we were to treat Bute differently from how we treat the 337 farmers in the east midlands or even all the other farmers who are getting a price that is based on the commercial value of their milk—if we breach that principle—it would be very hard to stand up in front of any other stakeholder and talk about fairness and consistency.

On your point, as soon as the board made the decision, we set up task forces to address the issues. The task forces included farmer directors, members of the business and local farmers. We have made significant progress with a number of long-standing issues.

For five years there has been, in effect, a haemorrhage of money in the organisation in Bute. I am glad to say that yesterday's announcement from the Scottish Government will help enormously. We have galvanised some action on logistics costs that are coming through that will close the gap substantially. We have also galvanised the local farmers to develop a four-week action plan, or business development plan, about other options for getting a sustainable longer-term higher price for the milk, which has to be a good thing.

The issue is what we do about the situation. As I said earlier, prices are volatile and they will change monthly. The issue that has come up in Bute could happen in Wales tomorrow and somewhere else a month later.

Jim Baird: First Milk is a true co-operative and this kind of issue is difficult—I do not underestimate that by any stretch of the imagination. A lot of the positive things that have happened would not have happened if we had just kept going and kept doing the same things as we have been doing for ever. Sometimes we have to ask ourselves whether, if we keep doing the same things, we will keep getting the same results. That is where we are: we have to think radically.

Michael Russell: The galvanising effect has been there. The transportation cost issue has been forced, and I am glad that the committee recommended that in its report. Other things have happened. However, if Mike Gallacher is saying that he believes that this inequity—because that is what it is—will be resolved within a few weeks by other actions because the price will be improved because the farmers are doing various other things, that is a step in the right direction.

Mike Gallacher: To be fair, you have put words in my mouth; I did not say that. I said that the prices will be volatile and that a 0.2p difference or a 1p difference could go either way in the coming months. The prices are adjusted every month depending on the value of the milk, which is volatile at the moment. What I am saying is that we can argue today about this difference, but the differences could be different next month.

The real issue that we must focus on is how we add value properly. The issue on Bute has been there for five years, at least. We need to ask how we can create more value for our farmers with that milk sustainably.

Michael Russell: I put on record that I believe that you should either reduce the retention—you could make a difference to that, even if you do not want to change the formulae—or you should take other actions to take away that iniquity, which is a barrier to the full and whole-hearted support that many would like to give the company in its recovery. This seems to have been the wrong thing to have done, and its contribution to the financial problems you had is absolutely infinitesimal.

Mike Gallacher: I appreciate that we have discussed this a lot over the past couple of weeks. We talked about the Myners review of the Co-operative Group. Something that has been established in a couple of reviews of co-operatives in the past year is that co-operatives have not made the decisions that they should have done. They have called it a values issue, but in my view this is not a values issue at all. It was a decision that had to be made and, as Jim Baird pointed out, making it meant we that will be able to direct the energy to fix the long-term problem. One of the issues with co-operatives is that they have not faced up to some of the difficult decisions that needed to be dealt with.

Graeme Dey: I would like to come at the issue from the direction of the public purse. We have seen the Scottish Government commit to invest in the Campbeltown creamery and yesterday we heard the announcement of £65,000 to assist the Bute farmers. How long do we have to wait until First Milk's Scottish operation is standing on its own two feet? Can we anticipate, over the next six months, year or whatever, further approaches to the Scottish Government to ask it to step in and support the Scottish farmers who are part of the First Milk co-operative?

Mike Gallacher: I welcome the support that has come from the Scottish Government. Some of these discussions have been going on for a long time and it is great to see that support. As a result of the transportation support that this committee has requested it seems that we are now treating dairy consistently with other parts of agriculture across the Highlands and Islands. I understand the impact of that support on the public purse, but it is something that this committee has argued for.

I had a good meeting with Richard Lochhead a couple of weeks ago. We explained that we were very quickly developing detailed business plans and that we would be coming to him with requests for more help—not just financial help, but help with leadership and bringing people together, which the Scottish Government has been doing very effectively. Richard welcomed that. There will be more requests for help, and that is the right thing, because we need to work together.

Dave Thompson (Skye, Lochaber and Badenoch) (SNP): Good morning, gentlemen. I am a wee bit confused and would like a bit of clarification on the price issue. If I recollect it correctly, you said that the price differential would be based on quality and value. Was the 1p reduction on Bute not stated to be because of the transport issues? That is not related to the product's quality and value. If you take that to its logical conclusion, you should have different prices for all your producers, depending on how far they are from their point of delivery to creameries and all the rest of it. If the principle holds good for Bute, it must hold good for everybody. It is not a principle that I would agree with, but that is purely a transport issue, not a quality and value issue.

Mike Gallacher: I meant value in terms of the value that is delivered from that particular farm. The work was done backwards from the customer, through to depot level, and then farm level. There was a very complicated spreadsheet that had all our collection depots, customers and farmers. That approach was consistent across the country.

Jim Baird: In response to your question, the approach did take into account delivery mileage to each depot. It was based on returns minus cost of delivery. That was part of the whole.

You could take it to the ultimate conclusion by taking it down to every farm level, but you have to stop somewhere. We stopped at depot level; that is how we worked it out.

Dave Thompson: I return to Claudia Beamish's point about the principles of a co-op. If they are to mean anything, transport costs are a really good example of something that should be equalised and absorbed across the whole organisation.

Jim Baird: I think that you will find that, even with grain co-ops, costs such as distance to the mill are taken into account as part of on-going business. Maybe we are just catching up on that.

10:15

Sarah Boyack: I would like to follow up on my first question on price and Claudia Beamish's comments about the company as a co-operative. If we were to go into a store and buy First Milk milk, would we know that it was your milk and would we know that it was produced by a co-operative, or is it branded with other companies?

Mike Gallacher: Part of our business goes through brands. Quark products that come out of the Glenfield creamery are available in retail under the Lake District brand—they are very good; I encourage people to buy them. A lot of our other products, particularly cheese, go through a business partner of ours, the Irish Dairy Board, with which we have a strategic partnership. It markets those products under our brands and also under its brands.

Jim Baird: We do not sell milk per se; we do not have a liquid offer. We just supply it to third parties.

Sarah Boyack: This goes back to your point about value and what consumers are prepared to pay. In the whole debate about the fair trade movement, the issue is that people pay a premium. The point about sourcing locally is that, although people are not necessarily paying more, they are paying for a particular product. There is clearly an issue about the value of what you produce as a co-operative, because you have lots of farmers banded together trying to make their own business.

I make this observation as someone who buys either Co-operative milk—which is presumably on the list of prices that we have here—or milk from two local farms. When I go to the shop, I have a choice of which of the two farms to buy from. As a consumer, I do not really have the option to buy First Milk milk, do I? That is an observation about the value of your product, which is partly about your brand and the farmers who produce it. Nobody knows that it is coming from Bute or any of the different farms you have.

Mike Gallacher: That is part of the conversation that we have had. We had meetings in Kintyre and Bute, as I said, and they were truly co-operative meetings—the whole local community was there, looking at real profit and loss statements and how we develop our business together. That was a key topic of the discussion, because consumers are willing to pay for a premium provenance product. Milk from Bute is of a very high quality and people are willing to pay for it, either as milk or in another format. We discussed that as a possibility for us as a business, and we need to move that forward.

Claudia Beamish: I would like to explore a bit more the issue of equity and co-operatives. I am aware of the big challenges and of the Myners review of the Co-operative Group that you highlighted. I am still a bit perplexed by some of the comments that you have made today. My understanding of the situation fits with the co-operative ethos. You are talking about the commercial value of milk; obviously you are a business and have to behave like one or you will go down like any other business, although businesses need support sometimes.

However, is there really the mutual support that I would expect to see within a co-operative business? You are talking about volatility affecting one place one month and then a different area of Scotland or the UK another month, and changes in value and niche markets and all that. I am not in any way suggesting how you should run the business, but I would expect to see more of an ethos of mutual support and sharing of risk.

Mike Gallacher: The point that I would build off that is that our ability to provide better support and better prices to our members is predicated on our commercial and financial success. The absence of that makes it very difficult to provide better levels of support to our farmers. In the end, in a very difficult market, all this boils down to being more commercially successful. Frankly, that gives us the resources to do a lot of things that we would like to do.

Jim Baird: Arla has an extended pedigree as a co-operative. A huge amount of capital has been built up in that business over generations, and there is a real ethos behind it. It has such a scale now that it can do as you suggest and pay an even price across Europe. That is great, but we do not currently have that luxury. We are in a business that has its challenges, and there is no point in pretending otherwise. We do not have the strength of capital behind us that Arla has. I would love to be able to do what it has done—maybe we will get there in time—but we have to deal with the realities in front of us and get through.

Claudia Beamish: What about the ethos that I am suggesting of more mutual support between members when there are differences in the commercial value and the transportation costs, and there is the month-by-month volatility that you have described? Is that being discussed?

Mike Gallacher: I go back to what I said. We have discussed the matter, and James Graham of the Scottish Agricultural Organisation Society was forceful in his point. He said that that is not a principle of co-operatives. It is very common to pay on the value. It is clear that paying everybody the same would be an alternative approach. We have not had that before in our business, and that is not our intent going forward. I understand the point, and some co-operatives could choose to do things in that way, but that has not been our approach, and it will not be.

Michael Russell: I know that you want to focus on the future, and a lot of the discussion has been about the future. What should the committee, the Government and Scotland do to support the producers and you, apart from getting out of your way and letting you get on with what you want to do, which I suspect might be Mike Gallacher's initial reaction? What do you think you now need? What predictions can you make—if you can make any—on what the situation will be in the next year to 18 months for all your Scottish milk fields and your company?

Mike Gallacher: There are a number of questions there. First, this discussion is entirely helpful. This conversation and the conversation that I had with Richard Lochhead allow us to work together more effectively and to galvanise all the stakeholders to deliver for the farmers. Getting a better outcome for our farmers must be our priority, and we cannot do that alone.

Predictions are predicated on prices and what is happening in the industry, of course. I do not have a crystal ball, but we have a plan to work on the things that are within our control. We have explained our wishes. We are going to get our costs down, operate more efficiently and engage our farmers with a clear line of sight to the different business units. Those different business units have very different challenges, which we need to address. Ultimately, that means earning our way in the world and getting a better commercial return for our milk, in whatever format.

We have committed to the committee, to the farmers and to Richard Lochhead that we will develop clear business plans that will say where we will be in order to become the international branded business that we want to be. This time, we will talk about year 1, year 2 and year 3—the building blocks. Businesses are not built overnight. We will also be specific about the help that we want.

Michael Russell: People have to live with insecurity and doubt, but there has been an awful lot of that. To speak in so far as I can for my constituents who are engaged in the business, I think that they want to hear from you that First Milk believes that it has a future in Kintyre and Bute and that it will work very hard to ensure that there is that future for the company and the producers. Can you give them that assurance?

Mike Gallacher: I cannot give any guarantees about what the market will look like in a year or two. If I put my marketing hat on and leverage some of my international experience, all that I can say is that Kintyre, Bute and Arran have a fantastic product that consumers in Scotland and around the world want. Our task is to deliver that product as quickly as we can in the right way under the right brands and with the right route to market at a premium price. We have a fantastic asset and consumers here and around the world who want that product. Our job is to build a bridge. I think that that is doable and that we must do it in the coming years.

Michael Russell: Thank you. That is helpful.

The Convener: I bought some Mull of Kintyre cheddar in Sainsbury's a couple of nights ago. I am aware that the Scottish dairy brand is going to be launched at the Royal Highland Show. The thing that attracts me is that I know that I can get a local product and that it is branded in that fashion, but it is one brand among many and, unfortunately, in the shops that I go into, the promotion of Scottish brands has not yet been beneficial for what is, as you say, a good product. Do you think that, in the end, the production of cheese in Campbeltown, on Arran and in other places needs to be part of your co-operative structure to win that niche market?

Mike Gallacher: Does it need to be part of it? I would want it to be part of First Milk, but that business model could clearly succeed in different ways. Our intent is to make the organisation successful. Having said that, as we do the strategy review, we are open to all options that are in the best interests of our farmers. It is a co-operative, and whatever is in the best interests of the farmers will be the best outcome for First Milk.

The Convener: Are you trying to expand the co-operative to have more farmers in it?

Mike Gallacher: No, not currently. We have not talked much about the reasons behind the strategy of structuring our milk pools in a different way. As we have aligned our farmers to our creameries, one of the things that we need to do over time is concentrate our milk fields and make them more efficient. We need to reduce our logistics costs and build the connection between those farmers and the creameries more clearly. We see expansion opportunities in Campbeltown, and as the tonnage coming out of there increases we will need more milk. By changing that way of working, we have enabled that expansion by creating a clear organisation in which milk fields are associated with creameries.

That is the thinking behind it. If we decided to expand and to recruit people, it would enable us to start recruiting. It has been difficult for us as a business to recruit farmers, and that is quite well known. Essentially, we have inherited farmers across the country but, unlike many commercial organisations, we have not been able to go out and recruit farmers as effectively as others have done.

Sarah Boyack: The convener has prompted me to think about what the contribution of Co-operative Development Scotland has been in providing assistance. There is the Scottish year of food and drink, the co-operative issue is quite important at a local level and it is obviously an important part of the ethos of your company. There must be lots of lessons to be learned from what has gone before. As well as your organisation, there are also efforts to promote co-operatives in the farming world. It has got to be more than just a good aspiration; there are some real business issues to be addressed, and it seems to me that Co-operative Development Scotland needs to be learning from that or helping you to move forward.

Jim Baird: The Scottish Agricultural Organisation Society has had a big role to play, and continues to be involved. Two members of the SAOS sit on the working group in Campbeltown and they have been a big help. They were involved in the scenario plan exercise, which I think is what Sarah Boyack was alluding to when she mentioned the other potential models. We take help wherever we can find it, and we find the SAOS a great organisation.

Alex Fergusson: My question is on a slightly different tack, but it is prompted by something that Mike Gallacher said earlier. He quite rightly pointed out that, as it is a co-operative, First Milk's producer members have a stake in the company. I represent Galloway in the south-west of Scotland, which is a hotbed of dairy production, as I am sure everyone is aware. Over the years, as is almost inevitable in this field, a number of members of First Milk have moved on and left the company, handing in their notice for their contracts and moving to other processors. As part of that contract, they were required to leave their capital investment in the company for five years.

Some of my constituents came to me this year to raise this issue. They were due to be paid some quite significant sums of money on 1 April this year, but First Milk has opted—for understandable reasons, I guess—to utilise what I understand is its right under the terms of the contract to delay repayment of the capital, which means that the producers will get nothing this year and a proportion over the next three years. This may be difficult for you to answer, but what guarantee is there that they will get their repayment over the next three years? Can the company extend the repayment period further if it is financially necessary to do so? What is the total size of that debt—if I can call it that—for First Milk?

10:30

Jim Baird: As you know, we have deferred payment to our members and we have asked them to contribute more capital to the business. We have had a fair bit of heat from them about that. They have been saying, "Look, we are paying more capital and these guys are taking the capital out the business." It was seen to be a hole in the bucket, so it was a no-brainer for the board to do that.

We cannot give any guarantees about capital. It is part of the business's on-going capital. I cannot remember off hand what the figure is, but it is a substantial sum. It is just one of those issues that we have to work with as a co-op. Other co-ops do not pay out. For example, Arla members would not get their full capital out of the business, because they leave a percentage—it is around 30 per cent—of the capital in the business. It is just one of the on-going things.

The capital structure that our board has inherited says that we will pay out in full. When the business is shrinking, that creates a challenge for us. No one is going to duck the issue, because it is an issue for the business. It is what it is and we have to deal with it.

Alex Fergusson: It would remain your intention, all things being well, to repay on the terms that were notified to those farmers this year.

Jim Baird: Yes, that is the intention.

The Convener: We have reached the point where we are looking for a way forward. We have had indications of that from you. We are not entirely happy with some elements of what you are doing, such as retaining capital in the business through the retention money and deferred payments. Obviously, we understand why that is, but we need to know what First Milk's commitment is to ensuring that there will be a Scottish arm of the business. Although, there is variety in the business, and you have inherited businesses that will give you milk, there must be clarity so that the people out there believe that First Milk will be able to deliver over the next period. We cannot predict long into the future, but we are left seriously wondering whether First Milk will be an on-going concern for Scottish farmers over the next two or three years.

Mike Gallacher: We have had conversations with different farmers across the country explaining the market conditions and our turnaround plan. If First Milk is to be successful, that will because we all work together in what is a very challenging market context. My request is that we all work together for that outcome for the farmers.

The Convener: Thank you very much for enlightening us about the matter so far. We will need to speak to you again some time soon, once we see how the situation starts to pan out. We have a particular responsibility to ensure that Scottish dairy produce has a future. If, as you say, customers demand that, we will want to see how that is best delivered. Thank you for your evidence.

The next committee meeting is on 3 June, when we will consider three pieces of subordinate legislation, take evidence from stakeholders on the implementation of the common agricultural policy application information technology system, and further consider petition PE1547, on the conservation of wild salmon.

We now move into private session, as agreed. I close the public part of the meeting and request that the public gallery be cleared.

10:34

Meeting continued in private until 10:52.

Members who would like a printed copy of the *Official Report* to be forwarded to them should give notice to SPICe.

Available in e-format only. Printed Scottish Parliament documentation is published in Edinburgh by APS Group Scotland.

All documents are available on
the Scottish Parliament website at:

www.scottish.parliament.uk

For details of documents available to
order in hard copy format, please contact:
APS Scottish Parliament Publications on 0131 629 9941.

For information on the Scottish Parliament contact
Public Information on:

Telephone: 0131 348 5000
Textphone: 0800 092 7100
Email: sp.info@scottish.parliament.uk

e-format first available
ISBN 978-1-78568-666-5

Revised e-format available
ISBN 978-1-78568-684-9

Printed in Scotland by APS Group Scotland