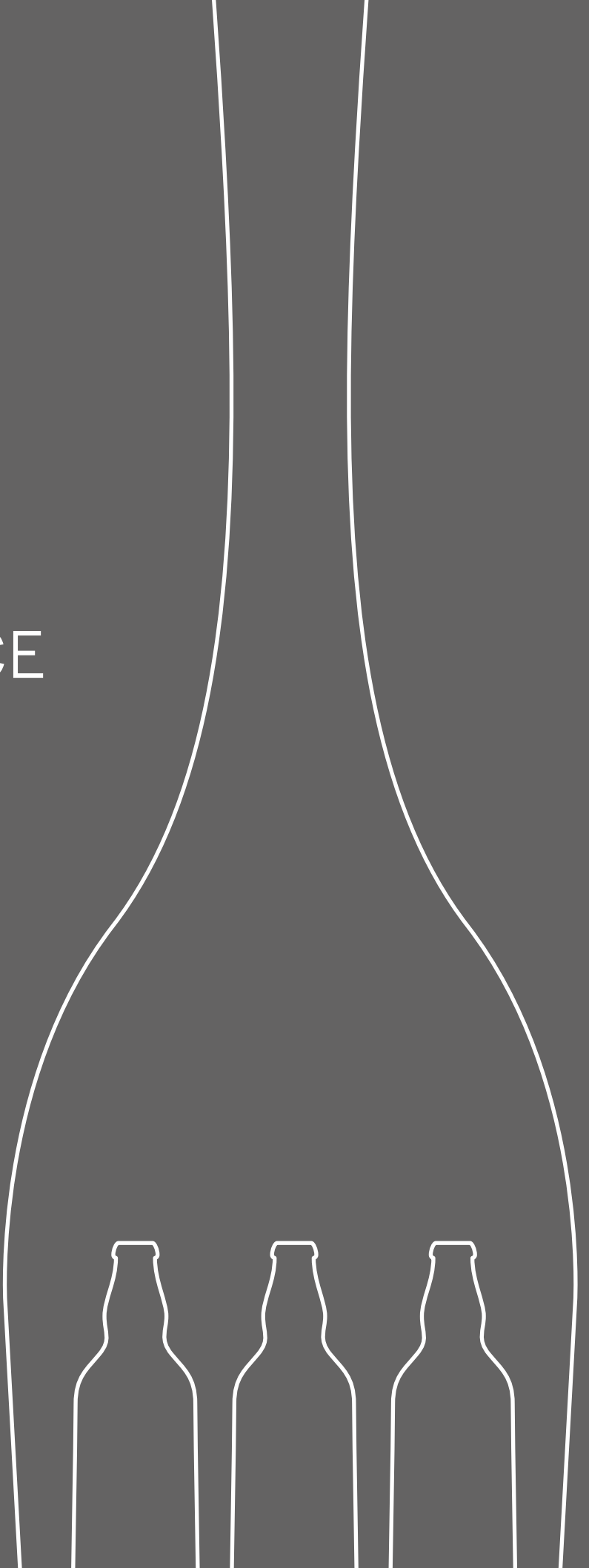


**SCOTLAND**  
OF FOOD & DRINK

INDUSTRY  
PERFORMANCE  
REVIEW

2016



THE SCOTLAND FOOD & DRINK PARTNERSHIP



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# INTRODUCTION

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## Past, Present, Future

Scotland Food & Drink (SF&D) is the industry leadership organisation tasked with growing the industry to a value of £16.5bn by 2017 and building Scotland's reputation as a Land of Food and Drink.

This Industry Performance Review, the first of its kind, is intended to analyse the progress we have made since the inception of the industry strategy that commenced in 2007, a strategy generated by industry partnership and public sector under the leadership of Scotland Food & Drink.

To gauge past performance we have used the latest official public data to evaluate historic growth against our targets and key performance indicators (KPIs), covering topics such as turnover, productivity, research and development (R&D) and exports. This data is best used to track our long-term results but, by dint of its method of collection, can only take us to 2013-14.

Given the fast moving nature of the food and drink business and the speed at which global events can unfold we have included two other measures to provide us with more immediate and actionable understanding. First, a range of industry partners have given us insight into the present and future challenges and opportunities within their sectors, using the extensive knowledge and feedback gleaned from their own members.

In addition, SF&D has been undertaking new research; a comprehensive Business Barometer Survey, conducted amongst food and drink producers at the end of 2015. This was designed to look into the near-future and reflect the confidence levels and investment forecasts of businesses and, in effect, complete the picture of past, present and future.

## Chairman and Chief Executive's view



David Kilshaw  
Chairman

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James Withers  
Chief Executive

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Less than 10 years ago, there was a debate within government circles as to whether the Scottish food and drink industry would be classified as a priority sector for Scotland. It is now unimaginable that food and drink would be deemed anything other than a central part of Scotland's economic future. We have come far.

Of course, the benefit to Scotland of thriving food and drink businesses goes beyond the economic impact. Our farmers manage our natural environment on a 24/7 basis, our fishermen and aquaculture sector create jobs in some of Scotland's most fragile communities, underpinning the social fabric of rural areas. Around one in eight of all Scottish jobs are now to be found somewhere along the food and drink supply chain.

This document, the first of its kind, casts an eye across all our key sectors. It looks back to assess progress and looks forward at opportunities. I hope you find it a source of both information and inspiration.

We are about to embark on the next stage of our food and drink journey. The new Scotland Food & Drink industry strategy will be written in 2016 and will chart a course to 2030. Our foundation is now strong, where once it was doubted. But we stand still at our peril. The next phase in efforts to grow Scotland's reputation as a Land of Food and Drink and drive growth will be just as important as the last. I thank all our partners that have been integral to the success of recent years and ask that you join us in shaping the next, exciting phase.

Collaboration. When asked what the single most important part of Scotland's food and drink success of recent years has been, that is my one-word answer.

Of course, it is simplistic. The growth journey highlighted in this report is a product of many things. Entrepreneurialism, internationalisation, innovation and ambition have all been building blocks too. Yet, it is in the complex art of collaboration where, in my view, Scotland has become a world leader in food and drink.

In many ways, this report itself represents the coming together of once disparate sectors. The rallying call that gave rise to Scotland Food & Drink in 2007, was founded on the belief that there was a common thread that ran through all businesses and sectors of our industry: the desire to be successful and build reputation.

Collaboration requires a leap of faith. The industry organisations, government agencies and member companies that made that jump nine years ago have had their faith pay off. Our industry is now recognised fully for its contribution to Scotland's growth and, more importantly, for the latent potential that still remains to be grasped.

No industry is without challenge. The last year has seen pressure on export performance and huge challenges at both farmgate and UK retail level. However, I'm clear that the partnership we've formed through Scotland Food & Drink leaves us well placed to tackle these head on.

# PAST

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Industry Progress 2007-2014



## Turnover

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2013

Turnover in Food and Drink stood at £14.3bn in 2013, up from £13.8bn in 2012 – representing an increase of 4% over the year.

This increase came despite some significant challenges and changes in the 2013 operating environment in Scotland, particularly in the areas of primary processing.

The closure of the largest pig slaughtering facility in October 2012 resulted in the Scottish pig kill and production volumes nearly halving in 2013. Processor output fell to an even greater extent, due to a major abattoir killing pigs on a contract basis rather than adding value within its own business. Cattle slaughterings at Scottish abattoirs fell and the total volume of beef produced fell by nearly 2.5%, due to lighter carcass weights.

Poultry processing too saw transformations with 2Sisters' acquisition of Vion's assets and the subsequent major restructuring of the supply chain.

Scotland's seafood sector saw impressive growth in 2013, up 19% from 2012. Exports of whole fresh salmon rose to a value of £450m (a 36% increase on the previous year's figures) with the prestigious Label Rouge niche brand reaching its highest ever sales level of almost 8,000 tonnes.

In Scotland re-structuring in the dairy industry following the merger of Müller and Robert Wiseman in 2012 had stabilised. In 2013, wholesale dairy prices in the UK were at their highest level for six years with Scottish dairy turnover actually 15% up year on year. This is a far cry from the steep declines that would begin in early 2014 and continue into the tough UK dairy environment we see today.

Scotch Whisky exports remained steady at £4.3bn in 2013 and Single Malt continued to increase in popularity. In volume terms, exports increased 3% to the equivalent of 1.3bn bottles in 2013 from 1.2bn bottles the previous year. France remained the largest volume market for Scotch. It was up 16% as it returned to normal following a tax hike on spirits at the start of 2012. Austerity measures in China, however, led to direct exports declining nearly 30%. (see 'Exports' for 2014 figures and further commentary).



## Turnover (£m)



Source: Scottish Annual Business Survey 2013 and Economic Report on Scottish Agriculture 2015

Target █ Actual █



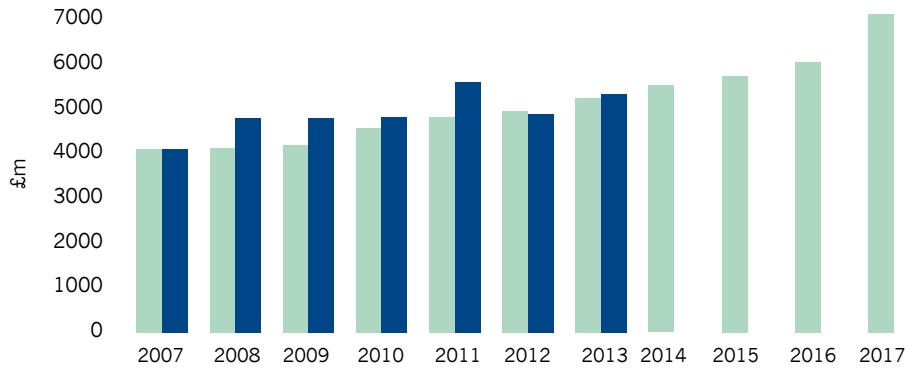
As independent and craft brewers made more inroads into both the on and off trades, home and abroad, turnover in this sector rose 28% year on year.

The UK retail environment in 2013: grocery inflation was, temporarily, tracking upwards, to 3.7% and grocery growth stood at 3.2% following losses across 2012. However by the end of 2013 both growth and inflation began to slide as input costs dropped and the major multiples began their price war in earnest.

Occasioned by 'Horsegate', traceability was high in the national consciousness in spring 2013. Whilst this had an adverse effect on frozen ready-meal sales it didn't appear to effect chilled, fresh red meat with sales holding up well in the UK during prime BBQ season. Despite volatile weather at the beginning of the year, strengthening consumer confidence saw the eating-out market in the UK returning to growth driven by coffee shops, sandwich chains and branded restaurants, a trend that has continued through to 2016.



## Gross Value Added



Source: Scottish Annual Business Survey 2013

Target █ Actual █

Gross Value Added (GVA) provides a measure for the wealth being generated by the sector and is calculated by estimating the value of the output less the value of inputs used in that production process.

GVA in the food and drink growth sector stood at £5.3bn in 2013, up by 11.5% year on year (nominal terms) although 2012 was the first year since 2007 in which GVA fell behind our industry target. Drinks manufacturing generated over £800m more in GVA than food, a result of the high-value-add generated by spirits production.

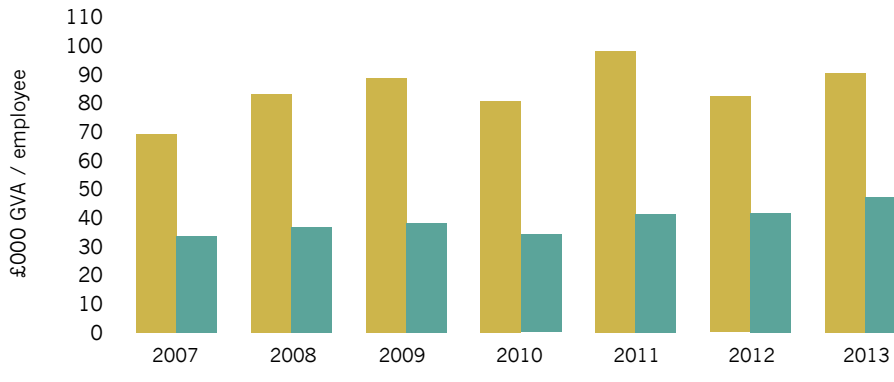
Good progress is being made towards 2017 but the pattern is more variable than turnover as input costs across a number of factors, including fuel and raw materials have fluctuated.

As for almost all products, crude oil is an input factor in the value added chain of most agricultural products (machinery fuel, fertilisers, transport) and the prices rose to a decade high level in 2013. Rising oil prices not only increased costs of production and distribution but also exacerbated the rise in commodity prices as demand for US maize for distillation into ethanol rose and this after a poor harvest for this crop.

However, wheat prices started to stabilise after poor global crop harvests in 2012. After a two-year decline palm oil prices were climbing but sugar continued its drop from record high prices in 2011.



## Productivity



Source: Scottish Annual Business Survey 2013

Food and Drink  Food only 

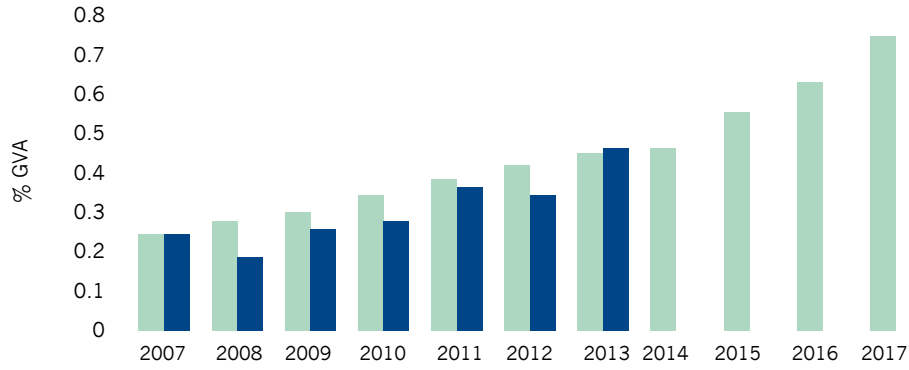
Productivity is not just a cornerstone of the Scottish food and drink industry but has been pinpointed as one of the key challenges to growth of the Scottish and UK economies.

Neither the Scottish nor UK economies can grow without increasing productivity. Since 2007 Scottish food and drink productivity, expressed as GVA per employee, has grown by 32% and food on its own at 35%. The industry strategy had set a target to benchmark Scottish food and drink productivity against food and drink productivity in the rest of the UK but changes in the way productivity is measured, in 2009, has meant the ex-Scotland figures are no longer robust comparators.

For 2013 the sectors showing greatest productivity growth were seafood and dairy with bakery maintaining the level it had achieved in 2012 when it had increased 29% from 2011.



## Research & Development



Source: ONS, BERD 2013

Target  Actual 

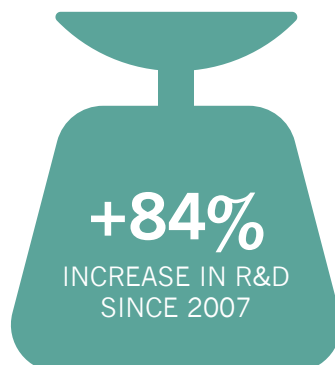
Investment in R&D has been identified as one of the key components to drive growth in GVA and turnover, with a pipeline of new innovations to feed into both the UK and export markets.

2013 saw the first year that R&D spend in the Scottish industry exceeded target as a number of industry support programmes, such as Interface Food & Drink, the Food and Health Innovation Service and the Reformulation project became fully on-stream. With our steeply accelerating R&D industry targets for 2015-2017 it is hoped that the embedding of innovation as part of industry culture will reap the required rewards.

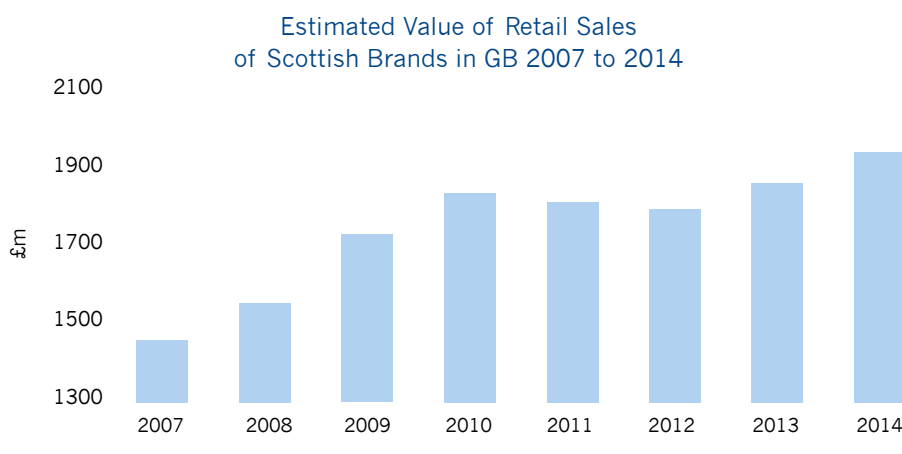
### Notes on Industry Progress Data

Turnover and GVA is taken from the annual UK-wide Business Survey (Office of National Statistics) with a boosted Scottish sample to improve the robustness of the Scottish data and published as the Scottish Annual Business Survey (SABS). Figures for agriculture are taken from the Economic Report on Scottish Agriculture 2015.

The targets referred to in the commentary were set in the Scotland Food & Drink Industry Strategy Refresh.



## UK Market



Source: Kantar Worldpanel

The hard work, collaboration and initiatives generated from the industry strategy, and reflected in the progress against the KPIs, has paid off in both UK and export markets.

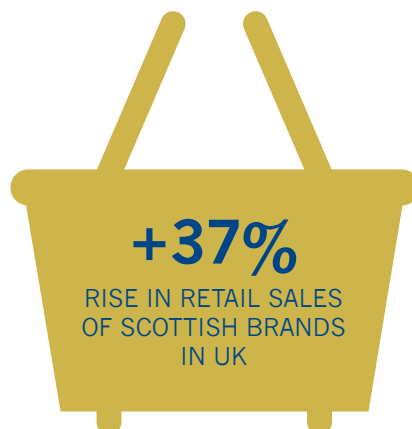
The estimated value of retail sales of Scottish brands in GB rose 37% between 2007-2014 to £1.9bn. This figure is perhaps even more impressive in context.

Grocery inflation in the UK retail market began to slow significantly in August 2011 and apart from a slight recovery in early 2013 it has continued its downward spiral to its current deflationary condition.

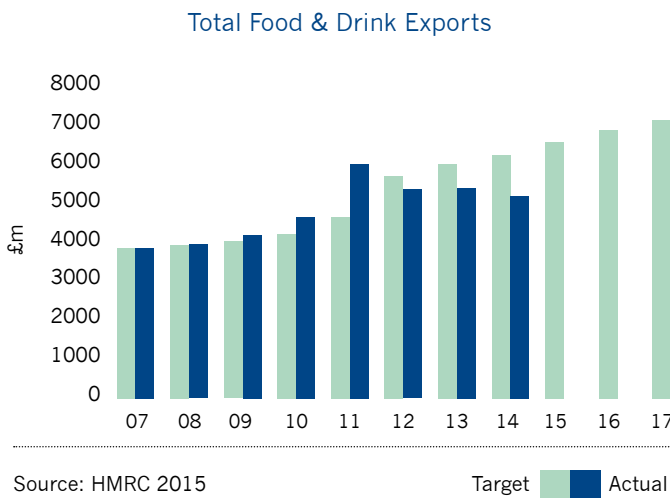
This figure just accounts for Scottish retail brands, an area in which we have been historically weaker.

Whilst lacking officially published data we know that many of our top producers have also increased their listings of supermarket own-label products.

Similarly an emphasis by companies on supply to the large UK foodservice operators (supported by programmes such as Access to Markets and Showcasing Scotland) has taken advantage of the market opportunity afforded by UK consumers returning to the out-of-home market, spending some of the money in cafés and restaurants that they have been saving on grocery.



## Overseas Exports



Scottish food exports have surpassed the £1.1bn mark for the first time, with total food and drink exports valued at £5.1bn in 2014.

The figures show that food exports alone grew by 3.5% on 2013, driven primarily by an increase in fish and seafood, which was up £38m.

Weaker economic conditions and political volatility in some markets saw the value of Scotch Whisky exports decline 7% to £3.95bn in 2014 from £4.26bn. Scotch Whisky has enjoyed strong global growth over the last decade, with total value of exports up 74% since 2004 and Single Malt up 159%. But the Scotch Whisky Association reported challenges in several markets in 2014 with the volume of exports also down slightly by 3% to 1.19bn 70cl bottles.

Growth was seen in a range of important markets, such as Taiwan where exports jumped 36% to £197m, partly on the back of the growing popularity of Single Malt Scotch. Exports to India were up 29% to £89m, despite the 150% import tariff.

The top international destination for Scottish food and drink remains the USA, with exports worth £800m followed by France, with exports of £734m in 2014. For the first time, Spain has entered the top three export destinations for Scottish food and drink, with exports valued at £247m. The fourth and fifth export markets,

ranked by value, are Germany (£208m) and Singapore (£202m) respectively.

The industry has also benefited from some strong increases in food exports to a number of growth markets during 2014, which has helped to balance the overall picture for food and drink exports. For example, food exports to China were up a massive 82% to £46m, mostly due to a 92% increase in exports of fish and seafood, and meat exports of £1.4m, following the lifting of an import ban on British pork. Food exports to the wider Asia and Oceania region were up 31% to £113m.

Similarly, food exports to the UAE increased 25% in 2014 from their value in 2013 to £124m, which is significant as it sees the UAE jump from 15th place to 8th in terms of biggest export destinations.

The largest share of food exports was in the fish and seafood sector, with international sales hitting £613m – up 6.6% compared to the previous year. The rise in value of fish and seafood exports was primarily driven by an increase in exports to Asia and Oceania (+£20m), the EU (+£15m) and Sub-Saharan Africa (+£11m) and has been aided by a collaborative industry effort to boost overseas demand for Scottish fish and seafood.

# PRESENT

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A view from the sectors



## Scotch Whisky Association



David Frost  
Chief Executive

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Scotch is clearly vital to economic success in Scotland. It makes up about three quarters of total Scottish food and drink exports.

Scotch overseas shipments, reaching around £4bn annually, adds more than £5bn each year to the UK economy, directly employs more than 10,000 people and supports a total of 40,000 jobs.

The last year has been an exciting one for the Scotch Whisky Association and the entire industry. We moved our Edinburgh headquarters to the prestigious Quatermile development and opened a new London office close to Westminster.

In the wider industry, several new distilleries opened. These range from start-ups such as the Glasgow Distillery to investments by existing players in the market, including Chivas Brothers opening its new Dalmonach distillery in Speyside. We know of up to 40 more distilleries planned, from Shetland to the Borders.

We have always been keen to support other sectors trying to expand overseas and in 2015 we teamed up with Scotland Food & Drink to launch our Export Collaboration Charter. This agrees 10 commitments that encourage the sharing of best export practice, knowledge, and networks across the Scottish food and drink sector.

We are confident the charter will deliver results in the coming months and years in helping Scotland reach its ambition of increasing exports from £5.1bn to £7.1bn by 2017.

And the Scotch Whisky industry continues to lead the way in sustainability with its award-winning Environmental Strategy. For example, only 2% of waste from Scotch Whisky packaging operations went to landfill in 2014, down from 13% in 2008. And use of non-fossil fuels to generate energy was up to 17% in 2014 from 3%. We are currently refreshing the strategy to make it even more ambitious and challenging.

Looking ahead we will continue to protect Scotch Whisky in overseas markets, building on recent successes in gaining recognition as a Geographical Indication – a product made in Scotland from water, cereals and yeast – in even more countries.

We will work to develop new export markets and we expect to see a return to growth overseas after some recent economic headwinds and political uncertainty.

## Seafood Scotland



Iain MacSween  
Chairman

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Seafood Scotland came into being because in one year some 7,000 tonnes of haddock were sent for reduction to fish meal because there was no market outlet for them.

Whilst the industry has progressed a long way since those times, it is again in a period of flux with the issues that surround the most fundamental change in fisheries policy with the introduction of the Landings Obligation. In addition, the political debate following the independence referendum and in particular the outcome of the Smith Commission have yet to be resolved.

One thing remains constant and that is the need to find appropriate markets for Scottish seafood as the industry cannot survive a “pile it high sell it cheap” strategy. It is vitally important that Scotland maintains a balanced portfolio of market development activity. And, whilst there has been significant activity to develop overseas markets in recent years, it is essential that Seafood Scotland maintains an appropriate focus on its domestic markets too.

Scottish fish farmers and fishermen are passionate about protecting the marine environment from which they make their living and are pioneering new technologies and participating in sustainable practices to preserve fish stocks for future generations.

The Scottish industry prides itself in harvesting and supplying a diverse range of premium quality seafood. It has worked hard to deliver an increasingly sustainable offering, often being one of the leading drivers in the EU to develop sustainable programmes to improve recovery of North Sea stocks and in taking forward a range of sustainably certified fisheries; from haddock, herring and mackerel, to mussels and crab. With an increasing number of stocks for major species in the NE Atlantic now being harvested at sustainable levels, the Scottish

seafood industry is well placed to build on its reputation for supplying premium quality, sustainable seafood in markets at home and abroad.

Links with the Scottish government have developed though the year; in particular, there is now a close working relationship with the food and drink team. We are working closely with Marine Scotland and have two notable projects ongoing with the Inshore Fisheries Technical Measures and a Creel Caught Marketing Fund.

The Scottish Seafood Partnership continues to support projects across the industry from developing a skilled workforce to investigating ways to collaborate and streamline supply chains and has recently gained significant momentum.

Joint working continues with Scotland Food & Drink with notable highlights including the development of the new Scottish branding and also the export strategy. A Market Driven Supply Chain project was developed in partnership with other trade organisations and Scotland Food & Drink and this is now beginning to benefit the seafood sector.

After many years of historically low fish quotas, there are encouraging signs that most stocks have recovered to a level that can sustain them being harvested at maximum sustainable yield for the coming years. This poses new challenges to the wild fish sector as the ability to market the fish to the best possible advantage will require a greater degree of collaboration across the entire supply chain. Seafood Scotland has a pivotal role in delivering that outcome.



## Scottish Salmon Producers' Organisation



Scott Landsburgh  
Chief Executive

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### For many years, farmed salmon has been Scotland's top food export.

It remains internationally recognised as the premium food in its class and for its animal welfare and environmental standards, all developed with a continuous drive for innovation across the sector.

Technological advancements are transforming the industry which has been growing sustainably in rural Scotland for over 40 years. The industry has invested considerable resources to employ the latest technologies which is why we continue to see improvement in our environmental performance. Achieving and maintaining such high levels of compliance underpins the industry's commitment to environmental sustainability and we make every effort to enhance our performance year-on-year.

Many people living in rural communities in the Highlands and Islands are reaping the benefits and enjoying the opportunity and prosperity it brings. Almost 2,500 people are directly employed by the industry with many more supported through suppliers and services.

Skill levels are rising as the industry includes specialists in biology, fish health, modelling, engineering, IT and supply chain logistics with many employees undertaking extensive in-house training or a degree level qualification. The Modern Apprenticeship (MA) scheme remains a critical element to industry succession planning with a total of 88 young people attaining certificates in 2015.

The programme also welcomed a further 37 new sign ups to MA Level 2 and Level 3, bringing the total number of new MA registrations to 74.

Sales of Scottish salmon have shifted in response to differing market conditions. Companies that operate in highly competitive markets must make difficult decisions in order to meet challenges and remain sustainable.

The domestic and European markets continue to be important with established markets like France continuing to do well and there is growth in Germany and Italy. The industry continues to field export enquires worldwide. However, it is clear that for strategic growth we need stable market conditions and a well-defined plan for production growth or it could remain susceptible to market volatility.

Overall, confidence within the industry is high. However, the planning process remains too complex and is challenging the industry's ability to grow sufficiently to achieve the industry production target of 210,000 tonnes by 2020. Minor upgrades to existing farm sites are time consuming and costly, and some of the conditions outlined in planning approvals are undermining investor confidence.

## Quality Meat Scotland



Jim McLaren  
Chairman

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The Scottish red meat industry has a great story to tell in terms of its value to Scotland's social, economic and environmental sustainability, as well as the ingredients for success in a world where demand for quality meat is increasing year by year.

We have the world's longest-running quality assurance schemes underpinning our industry's brands – Scotch Beef, Scotch Lamb and Specially Selected Pork. These schemes – which cover farms, feed, haulage, auction markets and processors – require businesses to meet a range of quality standards, including animal welfare.

Independent market research shows that quality assurance and animal welfare are increasingly important to shoppers and during the past year QMS established an 'Animal Welfare and Wellbeing Charter' and a formal partnership with the Scottish SPCA, Scotland's leading animal welfare charity.

There has also been some encouraging progress following lengthy talks with the other GB levy boards to recover levy which is lost as a result of livestock from Scotland being slaughtered elsewhere in the UK. This would take into consideration the scale of economic activity undertaken by the red meat industry in each country, rather than only where the animal is slaughtered.

Export markets continue to offer a valuable opportunity to maximise returns for the whole carcass, including parts for which there is little demand on the home market.

Another area of encouragement has been the investment in pig slaughtering capacity at Brechin, run by Quality Pork Limited, which is set to result in a very welcome increase in the volume of pigs slaughtered in Scotland during 2016. We look forward to having levy available which will allow us to resume promotion activities behind the Specially Selected Pork brand.

However, there are major challenges ahead too. The red meat market is highly competitive and a volatile global market means many factors affecting profitability, such as strength of Sterling and extreme weather, are out with the control of those who operate in the industry.

A further concern is the impact of recent CAP reform and changes to farm support payments which will mean lower payments for many livestock businesses, bringing farm profitability under pressure. While QMS is working hard to help our industry further improve its efficiency to offset some of the impact of these challenges, there is no doubt it is hard for producers to sustain cashflow and morale.

Looking to the longer-term, however, I believe our industry has a great deal to be positive about and Scotch Beef PGI, Scotch Lamb PGI and Specially Selected Pork are without doubt among the jewels in the crown of Scotland's fabulous larder.

## Scottish Bakers



Alan Clarke  
Chief Executive

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The bakery sector is sexy! Five years ago prime time television was filled with chefs, MasterChef was on BBC1 and a new programme called the Great British Bake Off appeared on BBC 2 and started to re-awake the public interest in baking.

However, we could not imagine how different the bakery sector is perceived today from where it was five years ago. Every chef in the UK appears to be turning himself or herself into a baker; the rise of the use of the word 'artisan' in everything from bakeries to cafés has fuelled the public's desire for fresh baking.

The sight of baking on TV, highlighting the science behind it, the technical skills required in the baking process and the presenters talking about baking bread and cakes rather than cooking them, has led to a home baking revolution. The aisles of the supermarkets are filled with home baking products and utensils.

This has led to many opportunities for bakers in Scotland and those that are following the trends and understanding that customers are changing are the ones that are prospering. Customers are often enquiring about the provenance of the product, the healthiness of the product and the freshness of the product. This has meant that many bakers have had the opportunity to develop high quality premium products which customers are prepared to pay that bit extra for.

This year has seen a number of new developments, Scottish Bakers have developed their own Export Group comprised of 10 bakery companies and worked in partnership with Scotland Food & Drink and other key food and drink trade associations to develop the food and drink export strategy for Scotland. This is directly helping

our members to identify new markets and the support they are receiving from the team at Scottish Development International is invaluable.

Another new initiative is the opening of in-store bakeries within Scotmid and other convenience stores. Convenience stores thrive on footfall and traditional reasons for shopping regularly, daily visits to buy cigarettes, newspapers and milk are all in decline and it has been identified that in-store bakery is a great reason for shoppers to visit. This has enabled shoppers to buy from their local baker who they already know and trust and has brought bakers a night time and weekend economy that they previously may not have had.

These successes have been against a backdrop of increased regulation. The new pension legislation and new National Living Wage will have a major impact on the costs to develop and sell high quality bakery products on a daily basis. This combined with the on average 20% reduction on funding for apprenticeship qualifications in our sector could have a major negative impact on the vital skills required to ensure that the bakery sector has the bakery and business skills required to make it a world leader.

On the positive side, our members have been actively contributing to the refresh of both the Scotland Food & Drink Industry Strategy and the Skills Investment Plan. Both of these initiatives are vital to the continued success of our sector.

## NFU Scotland



Allan Bowie  
President

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As primary producers, we are more conscious than ever that consumers, here and abroad, recognise and value the provenance and quality of the food and drink we produce here in Scotland.

I have spent my first 12 months in post championing that cause and we have much to be proud of.

In a UK context, farmers are at the start of a £100bn food and drink industry. We are the foundation stone of the largest manufacturing sector in the country and we support 4m jobs.

However, in Scotland, the importance of a healthy farming sector is more precious. It is the mainstay of an increasingly fragile rural economy and the bedrock on which the successful Scottish food and drink story is being built.

There is no getting away from the fact that it has been a hugely difficult year for Scottish agriculture but the industry continues to show great resilience in the face of huge levels of volatility in the marketplace and some of the worst weather seen in recent times.

While Scottish Farming plc takes great pride in what we grow and rear, to have a stronger food and drink industry we need that same passion to go all the way to the table or shelf.

And in return, we need a fair share of the margins being made to filter back to the farmgate if any level of confidence is to be maintained.

For the second year in succession, the value of Scotland's farming output has fallen. That is a sad and worrying statistic that all with an interest in the nation's food and drink sector need to take heed of.

Words like transparency, collaboration and accountability are often bandied about when we discuss food chain relationships. But, in too many cases, these remain ambitions rather than the dysfunctional reality.

It must never be forgotten that farming is vitally important to the wellbeing of this country and impacts on the life of every citizen. Farmers are rightly proud of what they do but they deserve a fair reward for the risks they carry every day as they go about their business of putting food and drink on our tables.

## Scottish Dairy Growth Board



Paul Grant  
Chair

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The Scottish Dairy Growth Board was formed in early 2014 following the publication of *Ambition 2025*, a study led by Scotland Food & Drink which developed a vision and strategy for dairy over the coming decade.

The strategy recognised the huge opportunities that lie ahead for the dairy sector in a global market. That dairy market has seen real challenges over the last year. However, the underpinning growth in demand remains and for a country like Scotland, where quality and provenance are our hallmarks, a sustainable future can undoubtedly be forged.

Three major activities, which were central to *Ambition 2025*, have become a focus of the Growth Board. The first is to attract investment in processing capability, and in particular in products not presently processed in Scotland which we know are in demand in key global markets. Much progress has been made on this front and the fruits of those efforts will unfold over the next 12 months.

The second activity, is the creation of a new umbrella brand for Scottish dairy. This collaboration is the first of its kind, with processors both large and small working together to develop a new national identity for dairy products made in Scotland and using 100% Scottish milk. This brand development, supported by Scottish Government, is being co-ordinated and managed in Scotland and focussed primarily to international markets. The Scottish Dairy brand, launched at Anuga 2015, includes 40 products, under 18 brands supplied by 13 processing companies.

Building brands and export markets take time, a lesson I have learned over the years! But I have seen the process deliver real growth and stronger businesses. We are now pursuing 20 market leads with the expectation that Dairy products from Scotland will be introduced into at least 10 markets by the end of 2016 and will continue to grow in 2017 onwards.

The third activity is the formation of the Scottish Dairy HUB, funded by both AHDB and Scottish Government to support farmers by offering free, independent advice in terms of how best to tackle problems and exploit opportunities. The Hub has made a real mark in the first year, dealing with 150 enquires from small, medium and large farms across the country and we expect this number to double in the second year.

I am very confident that these initiatives will meet the aspirations of the “*Ambition 2025*” report and translate opportunity into reality. 2015 has been a tough year for dairy but, if anything, it only served to emphasise the importance of the long-term journey we are on.

# FUTURE

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2016 Outlook and Business Barometer



## 2016 Outlook



“Foodservice will benefit as eating-out increases; retail margins will be hard fought for as competitive pressures in the sector, reduced food waste and soft commodity pricing conspire to create strong headwinds.”

Whilst crude oil dropped below \$30-a-barrel at the start of 2016, and is likely to drop further as Iran and Saudi Arabia fight for market share, it typically has less direct influence on food prices than big weather or political events. The Russian embargo on Western foods, exacerbated by the halting of its wheat trade with Turkey after the shooting down of one of its bombers, had a bigger effect on prices than the oil slide. Recent trade deals between China, Australia and New Zealand will start to have an effect this year with more dairy, beef and sheepmeat heading to the former.

Sterling has been hit by the prospect of a UK Brexit, plumbing a seven-year low against the dollar in February 2016. Whilst this may provide some short-term relief for exporters it presages a period of uncertainty and likely volatility leading up to the Referendum on Europe.

Supply and demand fundamentals for most agricultural commodities suggest deflation is likely to continue until at least the second half of 2016 but it's a highly varied picture. With prices at their lowest since the raw materials crash of 2009 the sector should “maximise the available opportunities now” according to Mintec.

Retail prices were nearly 2% cheaper in December 2015 than a year earlier (Grocer Price Index) while the FAO's Food Price Index, which tracks global food prices, was down almost 20% on 2014 levels.

Deflation was one of the watchwords for UK grocery in 2015. Driven by intense competition between retailers and underpinned by strong harvests and rock-bottom crude prices, food prices tumbled. With no signs of a let-up in the price war of UK multiples (Asda announced a further £500m to be pumped into discounts) and further gains from the discounters 2016 is promising much of the same.

In UK foodservice, intense competition amongst operators will keep menu prices fairly stable throughout the year but overcapacity in the market is slowing growth. The Olympic Games will be good news for a home delivery market that is already fast-evolving.

## Business Barometer Survey



“We are a small fish in a large pond and our reputation is crucial to deliver both UK and export strategies.”

In late 2015 Scotland Food & Drink conducted an online Business Barometer Survey across a wide spectrum of food and drink producers in Scotland. The aim was to gain insights into how much confidence the industry has that 2016 will prove to be another year of progress for the industry and to establish a base level for future business confidence tracking. We also used the opportunity to ask companies where they would be investing their time, money and resources in 2016 to better understand how industry support can be further tailored to their requirements and to provide grist to the mill of the new industry strategy.

### Survey Results - Summary

The overall view of companies is one of tempered optimism. There is a belief that whilst there are certainly headwinds in both the UK and global economies there will be good opportunities for growth in 2016.

Over half of the respondents forecast turnover increases in their business of 1%-10% with a small net increase in staff numbers. The main challenges are perceived to be financial (access to funding, currency fluctuations etc), macro-economic and the amount of demand in both the UK and overseas.

Every company told us that the UK market was important to them (very important for most) and whilst the retail channel formed the largest part of the customer base almost half the businesses were looking to do more business in the foodservice sector in 2016.

Overseas exports will also be more important to our companies, with North America, France and Germany being key targets. China, Japan and the Middle East will also feature prominently.

In order to generate opportunities both home and away companies will be focusing their efforts on research and development and investing more in innovation; specifically, in new product development, packaging and in manufacturing processes.

Finally, companies were almost unanimous in their belief that there were two key elements helping to fuel their optimism for near-future growth in the industry.

First respondents cited the extensive collaboration that already exists in the Scottish industry, something that they hoped would be fostered even more in the next 12 months.

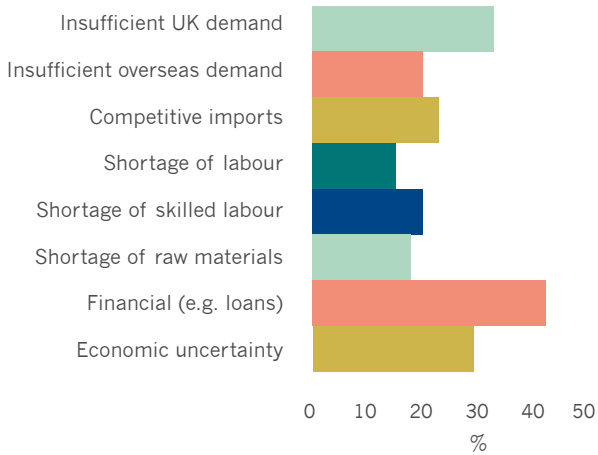
Second they believe that the growing reputation of Scotland's food and drink industry, home and abroad, is helping to build their own businesses as well as developing the industry as a whole.



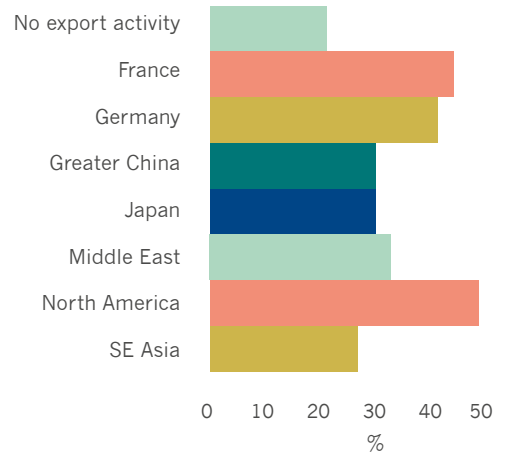
## Business Barometer Findings

Survey conducted online, October – November 2015  
Total Company Sample 115

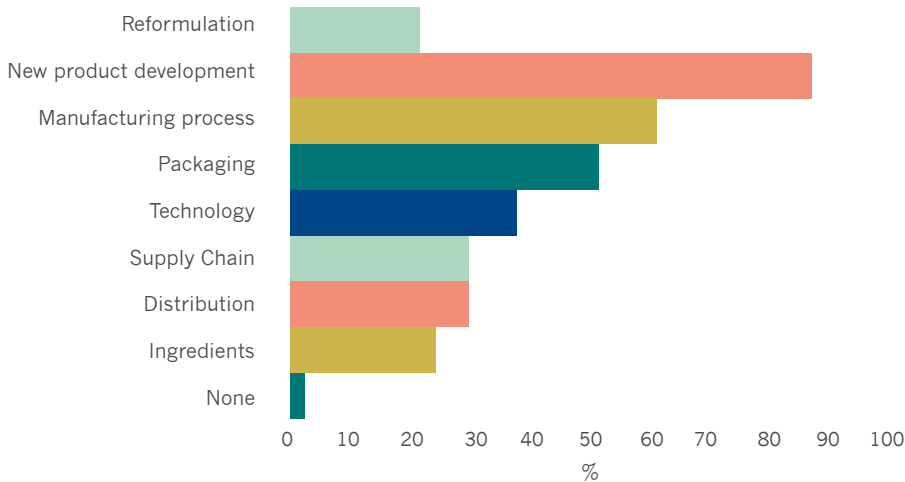
What factors will limit your ability to increase business activity?



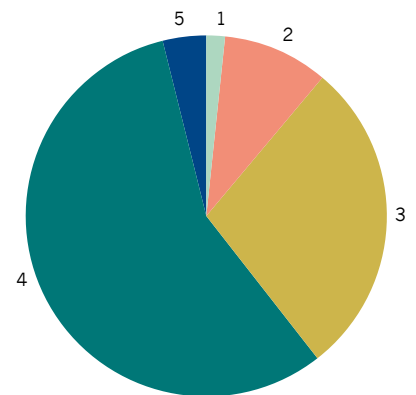
Which export markets will you target in the next 12 months?



Which areas will be the focus of your innovation investment (including R&D) over the next 12 months?



Excluding seasonal variations what net changes to staff levels do you forecast in the next 12 months?



How important will exporting (beyond the UK) be to your business in the next 12 months?

**67%**  
MORE IMPORTANT

How important will innovation (including R&D) be to your business in the next 12 months?

**51%**  
VERY IMPORTANT

1. A lot lower 2%
2. A little lower 9%
3. The same 28%
4. A little more 57%
5. A lot more 4%

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