

Plentiful Pastures?

Optimising
Business
Performance in
The UK Food &
Drink Sector





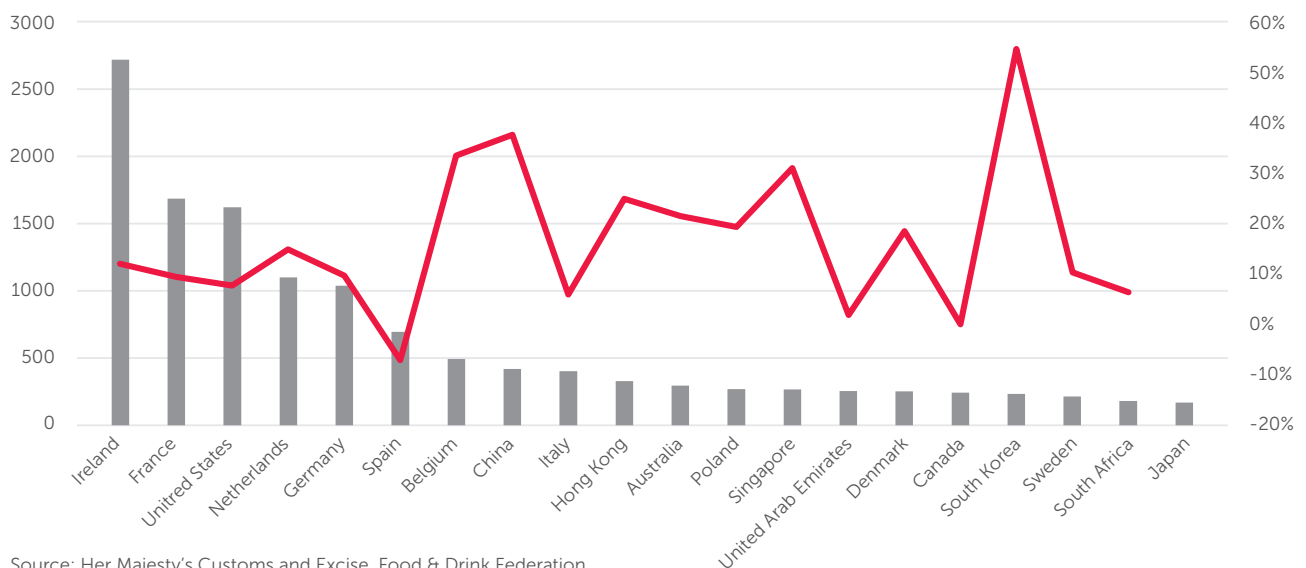
This white paper reviews the opportunities and challenges facing the UK Food & Drink Sector over the coming eighteen to twenty-four months. We provide an assessment of the main risks facing British F&D exporters and some guidance on how to prosper from future changes in the international economy.

An Overview of the UK Food & Drink Sector and a look forward to 2018

On the face of it, 2017 was a fantastic year for UK food and drinks exports. According to the Food & Drink Federation’s Exports Snapshot (Q3, 2017), UK F&D exports grew by 11.0 per cent YTD to Q3 in 2017. The EU dominated these figures with 60 per cent of all exports going to the region. However, in Q3 itself, Non-EU F&D export growth was significantly higher at 18.2 per cent compared to 12.5 per cent for the EU.

As seen in Figure 1, all of the UK’s top F&D export markets (excluding Spain) experienced significant year-to-date growth, with most markets recording more than 10 per cent change from the previous year. Ireland and France remained the UK’s top two markets but many non-EU markets (for example US, China, Singapore and South Korea) showed substantial growth over 2017.

Figure 1- UK Top 20 Food & Drink Export Markets 2017 Q3 YTD



Source: Her Majesty’s Customs and Excise, Food & Drink Federation

Diving further into those markets that showed the greatest improvements in export opportunities, Table 1 presents the top growing UK Food & Drink export countries with the greatest year-to-date change. Most of the countries in Table 1 are clearly non-EU markets and this presents the greatest opportunity and risk for the UK Food & Drink sector in 2018.



Table 1 – Top Growing UK Food & Drink Export Markets YTD Q3 2017

Market	YTD % Growth Rate
Philippines	289.1%
Latvia	116.1%
Iceland	73.2%
South Korea	54.6%
Romania	47.8%
Lebanon	42.7%
Qatar	42.6%
China	37.6%
Belgium	33.5%
Singapore	31.0%
New Zealand	29.3%
Hong Kong	24.9%
Israel	22.7%
Australia	21.5%
Russia	21.1%
Poland	19.3%
Denmark	18.5%
Cyprus	18.0%
Malta	16.0%
Netherlands	14.9%

Source: Her Majesty's Customs and Excise, Food & Drink Federation



A breakdown of the top export products is given in Table 2. Whisky dominates the UK export figures, followed by salmon and chocolate. Most sectors experienced growth in 2017 but there were notable exceptions, particularly in agriculture, where wheat (74.9% fall), pulses (12.0% fall), barley (42.1% fall) and vegetables (5.1% fall) all experienced sizeable declines in exports.

What caused such a fantastic and sudden improvement in the UK export data and is this likely to continue in 2018?

It could be argued the industry has become more attractive through improved quality and efficiency. This is a valid hypothesis given that some brand export markets are seeing much greater demand (e.g. salmon volumes increased by 21.2 per cent, YTD Q3 2017).

However, many sectors also experienced a drop in volumes even though the total sterling-value of exports increased. For example, although export revenues for beer increased by 11.8 per cent YTD Q3 2017, actual volumes fell by 4.2 per cent. A similar picture is presented for beef exports, which reported a 12.7 per cent increase in revenues but a fall of 3.1 per cent in volumes.

One should consider the role of currency exchange rate movements when assessing future export trends. A full 'sector by export market' analysis is beyond the scope of this paper, but a generalised FX rate by export market analysis can provide some broad insights.

Table 2 – Total YTD Q3 2017 Export Values and Growth Rates by Product

Product	Total Export Value (YTD Q3 2017)	Growth Rate Q3 YTD 2017	Product	Total Export Value (YTD Q3 2017)	Growth Rate Q3 YTD 2017
Whisky	£3,156,942,427	10.90%	Fruit juice	£94,747,593	11.30%
Salmon	£578,474,495	42.50%	Pulses	£92,957,286	-12.00%
Chocolate	£501,877,921	6.60%	Ice cream	£92,202,311	4.30%
Beer	£474,972,017	11.80%	Bread	£86,540,426	-1.80%
Cheese	£448,102,952	25.40%	Biscuits (savoury)	£84,134,011	12.10%
Wine	£412,436,734	21.50%	Wheat	£83,081,274	-74.90%
Gin	£387,307,598	11.40%	Vodka	£81,220,654	-27.70%
Beef	£360,880,916	12.70%	Tea	£77,470,560	7.40%
Vegetable oil	£334,408,202	46.50%	Sugar	£73,177,361	-19.30%
Pork	£329,680,668	18.30%	Crisps	£68,994,601	30.90%
Soft drinks	£320,912,699	-0.10%	Oats	£64,058,718	11.70%
Breakfast cereals	£317,066,043	10.90%	Eggs	£61,763,188	28.70%
Biscuits (sweet)	£293,843,441	6.90%	Whey	£53,153,432	11.50%
Lamb	£282,828,484	18.70%	Potatoes	£52,905,782	-3.90%
Chicken	£248,315,532	16.50%	Rapeseed	£52,771,161	-18.20%
Sauces & condiments	£246,876,488	5.20%	Smoked fish	£49,696,414	28.80%
Vegetables	£241,554,414	-5.10%	Nuts	£48,078,418	13.70%
Crustaceans	£235,643,538	13.30%	Soups	£46,948,323	20.80%
Liquid milk and cream	£234,793,015	73.70%	Vitamins & supplements	£45,257,583	-5.00%
Coffee	£206,350,852	14.00%	Waters	£43,466,562	12.50%
Cakes	£188,150,330	13.60%	Yogurt	£43,091,688	20.30%
Milk & cream (powders)	£187,985,159	11.40%	Pasta	£41,480,601	19.10%
Butter and spreads	£184,102,093	58.00%	Rice	£39,098,600	10.90%
Sugar confectionery	£160,016,716	9.40%	Jams & preserves	£33,453,229	31.90%
Fish fillets	£138,334,754	2.50%	Turkey	£29,856,859	13.20%
Molluscs	£129,314,814	-0.70%	Herbs	£28,368,340	38.30%
Animal oils	£118,202,101	38.10%	Spices	£22,728,924	10.80%
Fruit	£115,608,930	23.40%	Cider & perry	£21,306,376	-8.80%
Barley	£108,219,243	-42.10%	Sausages	£12,677,988	12.40%

Source: Her Majesty's Customs and Excise, Food & Drink Federation

Table 3 presents the net performance of UK export markets after stripping out the effect of sterling depreciation over 2016/2017. The difference column gives a very rough insight into the relative performance of UK Food & Drink exports to our largest markets, once the fall in sterling is taken into account.

Using Ireland as an example, although Food & Drink export revenues to the country have increased by 12 per cent in pound sterling terms YTD Q3 2017, from the perspective of the Irish market itself, the euro value of exports from the UK has fallen by about 4 per cent

based on pre-Brexit exchange rates. A similar trend is shown for all Eurozone countries (bar Belgium) and this clearly illustrates the difficulties Brand UK has faced in Europe since the Brexit vote.

The Non-EU picture is different. Even after incorporating sterling's depreciation, China, Hong Kong and South Korea export growth has grown substantially. These are potential markets on which UK Food & Drink exporters may consider focussing further in 2018 (but there are risks).

Table 3 – Relative Export Performance by Market

Market	Change	Currency Depreciation 23/6/2016 - Q3 2017	Difference
Ireland	12.00%	16%	-4.00%
France	9.40%	16%	-6.60%
United States	7.70%	13.15%	-5.45%
Netherlands	14.90%	16%	-1.10%
Germany	9.70%	16%	-6.30%
Spain	-7.10%	16%	-23.10%
Belgium	33.50%	16%	17.50%
China	37.60%	11.39%	26.21%
Italy	5.90%	16%	-10.10%
Hong Kong	24.90%	11.39%	13.51%
Australia	21.50%	16.39%	5.11%
Poland	19.30%	17.28%	2.02%
Denmark	18.50%	16.10%	2.40%
Canada	0.00%	13.63%	-13.63%
South Korea	54.60%	14.38%	40.22%
Sweden	10.30%	12.87%	-2.57%
South Africa	6.40%	20.11%	-13.71%
Japan	0.00%	9.94%	-9.94%



2018 Industry Trends and Strategies

Parallel to the financial trends presented in the previous section, the international Food & Drink sector is undergoing significant change and disruption. Table 4 presents the results of four independent industry trend surveys for the sector.

Table 4 – Food and Drink Trends in 2018

RSM (Jan 2018)	Mintel (Oct 2017)	Food Engineering (Dec 2017)	Frawley Neville (Dec 2017)
Changing customer preferences	Food safety and sustainability	Food sustainability	Trust (transparency, stated origin and ethical treatment of producers)
Mergers and acquisitions	Greater focus on F&D as integral component of lifestyle design	Lifestyle foods	Self-care routines (healthy diet & lifestyle)
Food safety	New textures and Sensations	Processing technologies and their links to health benefits	Stress Alleviation (consumers seeking to form healthy habits)
Food sustainability	Greater diversity of online and mobile food shopping	Packaging sustainability	Individuality
Technological disruption	Technological disruption	New coffee and tea products	Sustainability

Some commonalities exist among the four surveys.

A greater focus on food safety and transparency.

A lack of trust in food & drink institutions has grown in recent years and this is expected to continue in 2018. Food retailers and manufacturers will be under more pressure to provide information on the provenance of ingredients, production process quality and supply chains.

Although the need to provide more information on products will be more severe, this is also a market opportunity for those companies that can prove and effectively market their natural, ethical, or quality products.

Lifestyle design

Lifestyle design is an important growing area with heightened consumer demand for food and beverage choices that are consistent with chosen lifestyles. Greater diversity and customisability of food and drink products will become more common, as consumers demand a broader choice across food types and more immediacy in their online purchases.

This year, we are likely to see new online start-up services in the food & drink sector, specifically geared toward providing customers with deliveries from local food suppliers, such as dairies and farms, as well as

speedy out of hours delivery. Existing businesses should also consider extending these delivery options for their food and drink products.

Technological disruption

Technological disruption in food manufacturing and efficiency improvements will come from automation in 2018. In addition, social media and mobile applications will become central to building business. With almost all consumers now familiar with websites like Tripadvisor, Skyscanner and Amazon, Food & Drink firms must put themselves in a position to take advantage of the opportunities arising from the internet. Even locally sourced products should seek to have a web presence highlighting the quality of ingredients, online purchasing, health benefits and other information that may be of interest to buyers.

Technology will also allow food & drink firms to set up subscription services, home delivery, and automatic replenishment of supplies. Suppliers should progressively consider using technology for innovative solutions to improve efficiency and productivity of services through machine learning of past purchasing behaviours.

Innovative and new products

There are always new product innovations in response to emerging consumer demand, and 2018 will be no different in this regard. According to RSM (January, 2018), new innovations will centre on bold and exotic flavours, snacking and health and wellness foods (such as kale and quinoa), possibly forming part of a raw ingredient home delivery service.

Waitrose (Dec 2017) has suggested several growth areas for 2018 including Japanese cuisine, Indian street food, and high protein plant products. Similarly, innovative coffee and tea products have experienced increased demand over the past twelve months and this is likely to continue into 2018.

Food & Drink Export/Import Performance Predictions for 2018

Two key strategies will drive UK Food & Drink export performance in 2018: Innovation and Currency Movements.

Innovative business strategies

Changing global consumer trends provide an opportunity for resourceful and innovative food manufacturers to benefit. According to a 2017 sector bulletin from Santander and the manufacturers' trade body, EEF, the frequency of veganism and vegetarianism increased by 257 and 25 per cent respectively between 2010 and 2016, and this has led to a reduction in salt, sugar and fats in many products. Free-From and Organic products are also of rising importance among consumers, as lifestyle choices dominate buying behaviours.

As the middle classes grow in India, China and South Africa, it is likely that similar food trends will be exhibited in these and other emerging markets. This is an increasingly important market segment for many food manufacturers and all food and drink companies should be refreshing their export strategies to take advantage of these trends.

In this regard, intelligent and active packaging will become more ubiquitous in 2018. Entrepreneurial firms will embrace technological innovations to control moisture and oxygen atmosphere, in addition to logging and managing temperature variations during transit. These disruptive technologies will enhance shelf life, improve product quality, and enhance export value in geographically distant markets.

Foreign exchange movements

As Brexit trade negotiations progress, exporters should identify target markets that will likely perform well in relation to sterling over the next twelve months. Irrespective of the outcome of trade negotiations (hard or soft Brexit), the uncertainty surrounding UK's trading

relationship with the European Union will become much clearer. This has the potential to increase the value of sterling in relation to other currencies over the second half or final quarter of 2018.

Any strengthening of sterling will make UK food & drink exports less competitive in comparison to 2017 and will probably reduce the year-on-year growth rate of foreign country F&D sales. Imports will, by default, become cheaper and so food & drink manufacturers should prepare for more challenging trading conditions towards the end of 2018.

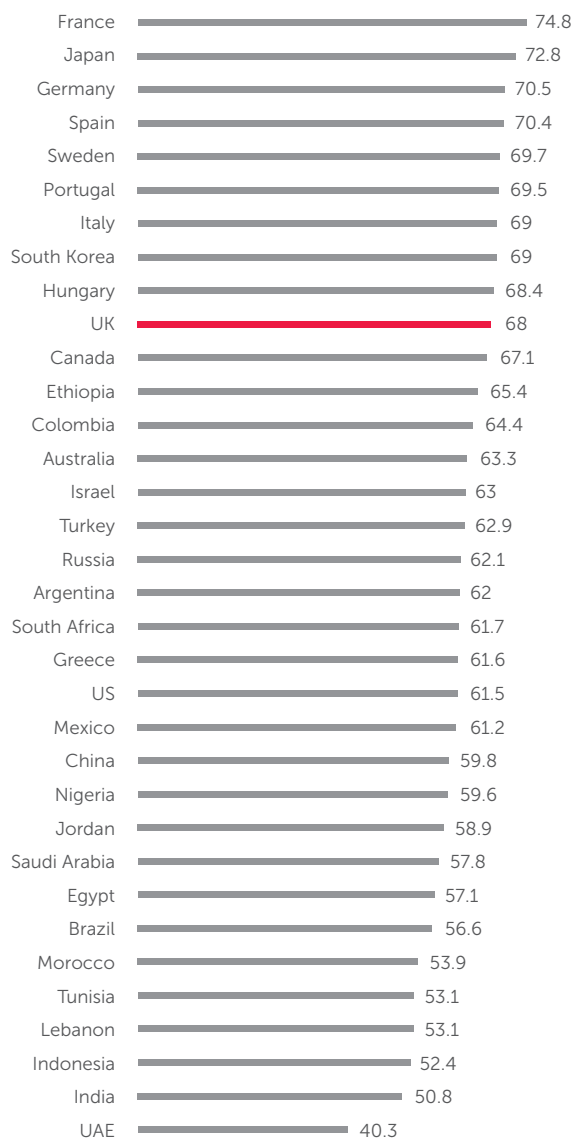
Despite this, the UK Food & Drink sector is efficient in comparison to other countries and if more investment is made in innovative product design, new market growth will offset any deterioration in competitiveness that is driven by currency movements.

Looking beyond 2018: Food Standards – Brexit Implications for Food & Drink

Opinion is divided on the impact of Brexit on UK food and drink safety standards. On the one hand, the British government has repeatedly emphasized it remains fully committed to maintaining (and even improving upon) the high level of standards developed by the EU over the past thirty years. Concern exists, however, that the desire for new trade deals with the US, China, India and other non-EU countries will reduce the quality of foods available in the UK.

In Figure 2, the 2017 Barilla Center for Food & Nutrition Food Sustainability Index is presented for a sample of countries. The index is based on three areas: sustainable agriculture, nutritional challenges, and food loss and waste. While the UK is one of the better countries for food sustainability, other European countries perform better in the index and those countries targeted for new trade deals are positioned much lower in the rankings.

Figure 2-Barilla Center for Food & Nutrition Food Sustainability Index 2017



Arguments for the maintenance or improvement of food standards

The UK government has gone on record that it will not pull back on existing EU animal welfare standards once Brexit has been enacted. Specifically, the Environment Secretary, Michael Gove, informed the Environment Select Committee in December, 2017, that, ‘...there should be no compromise on high animal welfare and environmental standards... those animal welfare rules are things we will not compromise.’

If the UK is to improve on the EU’s already high standards and prosper in an environment with low subsidies, it should look to New Zealand as a successful case study to emulate. In 1984, New Zealand government support to agricultural producers fell from 30 per cent of production value to 2 per cent, the lowest in the OECD at the time. The country focussed on three priorities to deliver transformative growth in the sector: new markets, new high margin products, and improved productivity through technology. By concentrating its efforts on maximising the value of each priority, productivity growth reached an average 2.5 per cent per annum compared to 1.5 per cent in the pre-reform period.

The UK could replicate this success post-Brexit and improve standards at the same time if its agricultural policy prioritised animal welfare, the environment, and the development of high quality innovation and entrepreneurship in the Food & Drink sector.

As Michael Gove emphasised in a July 2017 speech, Brexit could be “...a once-in-a-lifetime opportunity to reform how we care for our land, our rivers and our seas, how we recast our ambition for our country’s environment and the planet.”

Arguments for erosion of food standards

The major concern facing the UK Food & Drink sector is that trade agreements with non-EU countries in a post-Brexit environment will lead to the UK accepting lower food standards. This is a very real issue and one that could have a massive impact on UK food & drink producers.

Any trade deal that reduces regulatory barriers will necessarily bring greater competition between companies operating in the countries covered by the agreement. If the other country has lower food standards, UK producers will need to cut costs to remain competitive and this could lead to a fall in standards in this country.

Possible unintended consequences of new trade deals could be lower expectations relating to animal welfare, biodiversity, ethical production and the environmental agenda. Examples that have been discussed at length in the media such as chlorinated chickens from the US, would be one of many poorer quality products that could enter the market if a trade deal ‘at any cost’ was made by the UK government.

Strategic and Operational Recommendations for 2018 and Beyond

It is clear the rate of change facing the UK Food & Drink sector will continue unabated over the next twelve to twenty-four months. Firms should be prepared to address both long and short-term considerations in their strategic planning. The list below presents some areas F&D managers will be thinking about.

Currency movements

If, as expected, sterling appreciates over 2018, exporters may consider locking in the pound's value today for delivery in the future by using a currency forward contract.

One way to gain more flexibility is to use a hedging strategy which could give the holder the right (but not the obligation) to buy or sell currency at a known rate decided today albeit at the cost of an upfront premium.

An active foreign exchange hedging strategy can reduce the risk of international trading and provide a smooth overseas income stream that mitigates foreign exchange risk.

Importers should also consider a currency hedging strategy to minimise foreign exchange risk. Clearly the expected future movements of foreign currency denominated purchases will determine if an active or passive strategy should be pursued.

Moneycorp customers can hedge future foreign exchange payments and receipts easily and lock in currency rates for up to 24 months ahead by using forward contracts. More sophisticated businesses may also want to investigate the use of foreign currency options based solutions.

New markets

Many emerging markets, particularly in Asia, are opening up to foreign products because of a growing middle class segment. In addition, the EU's recent free trade agreements with Canada and Japan will provide considerable new growth opportunities for UK farmers and food producers.

Food & Drink firms should investigate the viability of entry strategies to new markets, including joint ventures, exports, foreign direct investment and licensing. Interested parties should check out the 'Open to Export' website, www.opentoexport.com, which provides excellent resources for Food & Drink companies considering international expansion.

Increasing market share

As consumer tastes evolve both in the UK and across the globe, Food & Drinks firms have an excellent opportunity to capture new business through innovating their own product lines. In this white paper, we have highlighted a variety of potential ways in which the Food & Drink sector will change over 2018 and beyond.

Companies should review their existing products and services and identify potential ways in which to adapt their strategies to capture future consumer demand. First-mover advantage will lead to improved market share and stronger revenues.

Conclusions

We started this report by stating that 2017 was a fantastic year for the UK Food & Drink industry. While 2018 will probably be more unsettled, there are clear opportunities for entrepreneurial companies to benefit from future changes in the sector. By preparing now, they will reap the benefits in the future.

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