Food and Drink Federation response: Low Pay Commission Consultation 2023

Introduction

1. This submission is made by the Food and Drink Federation, which is the voice of the UK food and drink manufacturing industry, the largest manufacturing sector in the country, with a footprint in every parliamentary constituency. Our industry has a turnover of more than £128bn, accounting for 20% of total UK manufacturing, and contributes over £33bn in Gross Value Added (GVA). Food and drink manufacturers directly employ over 450,000 people across every region and nation of the UK. 97% of our industry is made-up of small and medium-sized businesses.

2. The FDF broadly supports the Low Pay Commission's (LPC) proposal to increase the National Living Wage (NLW) in April 2024 between £10.90 and £11.43 with a central estimate of £11.16 – in line with its stated target of bringing the National Living Wage up to two-thirds of median earnings by 2024. Whilst these proposals will further increase business costs and impact pay differentials especially for SMEs, we recognise that they are appropriate in the context of the cost-of-living crisis which is particularly impacting workers in the lowest pay bands. However, we urge the LPC to proceed with caution and retain the flexibility to alter their projections in response to economic changes. For instance, if inflation were to fall closer to the Bank of England target of 2%, then the on-target National Living Wage rate should be amended to reflect this so as not to add to the significant cost pressures already facing businesses, in particular SMEs.

3. The FDF supports any steps being taken to create a higher wage, higher skilled economy including but not limited to improved wages, particularly given the central role food and drink manufacturing can play within the UK Government's plans to grow the economy and create better-paid jobs right across the country.

The National Living Wage

What has been the impact of the National Living Wage (NLW) in the past year, including the rise to £10.42?

4. Food and drink manufacturers pay competitive wages around and above the national average. According to national statistics, median annual pay in the in 2021 UK was £25,990 across all sectors. This compares to the median annual pay in the sector of £24,528 in the manufacture of food products and £30,392 in the manufacture of beverages[1]. Pay in the sector rose by 4.1% over the last 12 months and is expected to increase by another 5.4% over the next year.

5. As has been the case in previous years, larger food and drink manufacturers have reported that most roles are either paid above NLW and tend to be paid annual salaries rather than hourly wages. Consequently, the impact of any changes to NLW on larger food and drink manufacturing companies is limited. However, in instances where employers pay above NLW, any increases to NLW rates will require businesses to push up wages as they seek to continue paying above the rate. Anecdotally, companies have reported that pay differentials have been squeezed even further. Over the last year, pay settlements were around 4-6% while those on

[1] ONS ASHE Table 5.6. 2022 data is not available for manufacture of beverages; for reference, median pay in the UK stood at £27,756, and median pay in the manufacture of food products at £25,860.

NLW rates saw an increase of around 9-10% – resulting in compressed wage rates between those operating in roles just above entry level roles.

6. The impact on small and medium sized enterprises (SMEs), which make up 97% of the food and drink manufacturing sector, is more significant. Smaller firms seemed to have absorbed a larger share of cost rises than larger companies. On average, respondents to our Q1 FDF State of Industry Survey reported total costs increased by 15.4% over the year to March 2023, while their selling prices rose by 12.5% only. By business size, changes in costs and prices, respectively, are the following: larger companies (turnover: £500m+): 15.7% and 13.0%, mid-size companies: 12.8% and 7.2%, while smaller companies (turnover: <£25m): 10.7% and 4.6%. Furthermore, increases in NLW rates have caused pay differentials in some smaller businesses to almost disappear as they cannot increase the wages of higher paid staff due to pressures elsewhere. We are already seeing worrying signs with broader cost pressures in the sector. For example, in 2022 the number of insolvencies in the industry were double than in 2019. Specifically, there were 122 insolvencies in 2019 and 244 in 2022. This compared to a 15% increase in manufacturing insolvencies and nearly 25% more nationally.

7. Whilst employees of food and drink manufacturers are more likely to be paid at or above NMW/NLW levels, there is greater pressure in other parts of the food chain which are crucial to the success of the supply chain. Food and drink manufacturers can find themselves squeezed in the middle, unable to pass on cost increases from growers, labour providers and logistics companies, onto customers in the retail and hospitality sectors.

To what extent has the NLW affected different groups of workers, particularly those with protected characteristics (for example women, ethnic minorities) and migrant workers?

8. It is difficult to fully gauge the extent to which different groups of workers are impacted by the NLW as currently there is only a requirement for large companies to report gender pay and no legal requirement for companies of any size to report pay along the lines of other protected characteristics such as ethnicity.

9. Regarding gender pay, the pay gap in food and drink manufacturing is lower than in other sectors (Table 1). In both the manufacture of food and beverages, the 2022 median gender pay gaps are smaller than the pay gaps for all manufacturing sectors and all other sectors.

Table 1: Mean and Median Gender Pay Gap 2022

Sector	Gender Pay Gap Median (%)	Gender Pay Gap Mean (%)
Food manufacturing	**12.0**	**10.4**
Drink manufacturing	**13.0**	**15.4**
All manufacturing	**16.7**	**11.3**
All UK sectors	**14.9**	**13.9**

Source: ONS

10. One reason for the relatively smaller pay gap within the sector is the tendency for lower representation of women within factory roles but a more even gender split in office-based roles. In some cases, the proportion of women in management roles is higher than the proportion of women overall in the business. For example, at Board

level, over the last five years the food and drink manufacturing sector has seen the largest growth (57.8%) in representation of women on Boards.[2]

At what level should the NLW be set from April 2024? Our current central projection for the on-course rate is £11.16 within a range of £10.90 and £11.43.

11. The LPC is estimating a 7.1% increase for the April 2024 NLW rate of £11.16. This new projection will lead to significant increases to costs for businesses already facing costs pressures because of higher energy and commodity prices, supply chain challenges and poorly designed regulations that will be coming into effect. Resilience in food and drink manufacturing has been eroded after a sustained period of unprecedented economic uncertainty from the Covid-19 pandemic, Brexit and the war in Ukraine.

12. Despite these difficult economic conditions, the FDF is broadly supportive of the LPC's proposals regarding increases to NLW rates. The significant increases to the cost of living mean that the LPC's proposed on-course rate seems appropriate and proportionate. Furthermore, given our industry's significant potential to help grow the UK economy and create better-paid jobs and opportunity right across the country, the FDF supports any steps being taken to create a higher wage, higher skilled economy, including but not limited to improved wages. We are calling for a joined-up workforce strategy to support this transition to a higher wage and higher skilled economy – that focuses on the role of skills policy, migration, technology, labour market intelligence and pay.

13. However, we would also urge the LPC to proceed in line with their projections and targets with caution and retain the flexibility to alter their projections in response to economic changes. For instance, if inflation were to fall closer to the Bank of England target of 2%, then the on-target National Living Wage rate should be amended to reflect this so as not to add to the significant cost pressures already facing businesses, in particular SMEs. Furthermore, in the current high inflationary environment, high rises in the NLW rates, which put upward pressures on wages in general, risk fuel the wage-price spiral. This would make it more difficult for the Bank of England to bring inflation under control, thus prolonging the cost-of-living crisis.

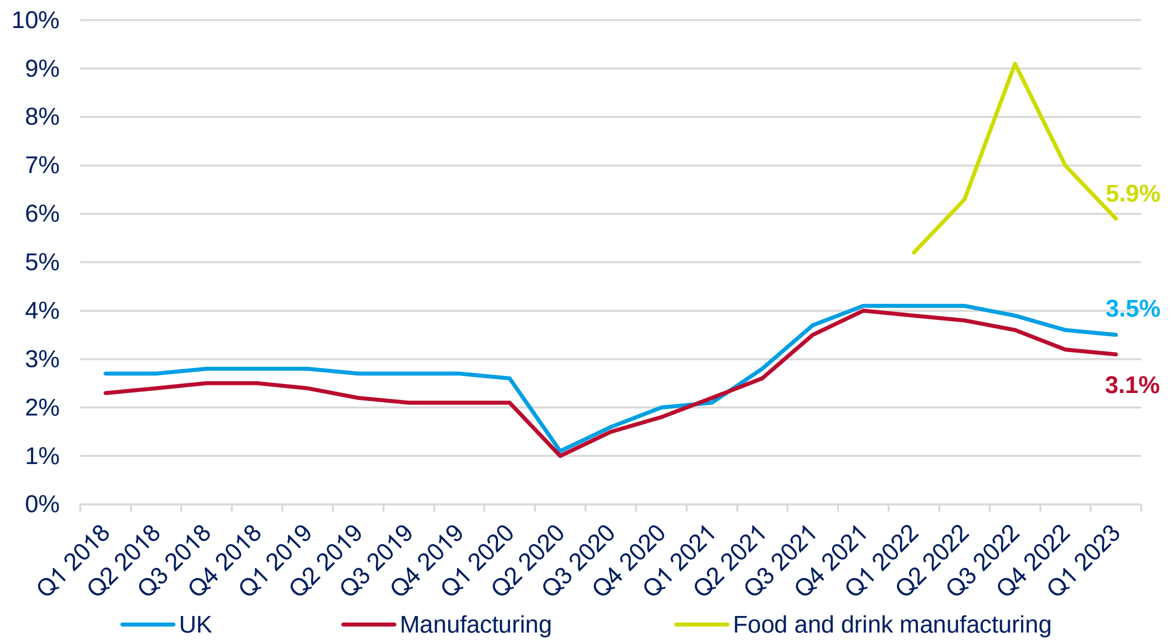
Recruitment challenges and opportunities

Why have employers found it difficult to recruit since the pandemic?

14. Food and drink manufacturers have been experiencing persistent severe staff shortages across a wide range of roles and skills, reporting 5.9 unfilled positions for every 100 jobs in Q1 2023, down from 7.0 in Q4 2022 and 9.1 in Q3 2022. It's noteworthy that labour shortages were significantly more acute than across the economy or the whole manufacturing sector (Chart 1). Indeed, in Q1, vacancies in the industry were almost double than vacancies in the whole manufacturing sector and significantly above the UK average.

[2] Overview of women in the food and drink industry, Grant Thornton, February 2023

Chart 1: Vacancy rate in UK, manufacturing and food and drink manufacturing *(number of vacancies per 100 employees)*



Source: FDF State of Industry Survey and ONS

15. Labour shortages in the industry have been reported across a wide range of roles and skills. Specifically, the industry is in short supply of:

    - *High-skilled workers*: R&D specialists, engineers, procurement specialists, scientists, commercial, finance, and marketing roles.
    - *Technical specialists*: bakers, specification technologists, food technologists, new product development (NPD) technologists.
    - *Production operatives*: production and machine operatives, delivery drivers, packing operators, night shift workers.

16. While these acute labour shortages have eased somewhat in the last few months, many food and drink manufacturers are managing to fulfil current orders by offering overtime to existing employees, but this approach is unsustainable and has implications for longer-term productivity and growth.

17. At the mid- and high- skill end, the quality of STEM education in the UK is exacerbating skills shortages among engineers and food scientists in particular. With very little provision for food science specialisms in the UK, members have often turned to Europe to recruit where there is greater provision for these subjects. This has become even more difficult with the length of time and cost involved in bringing in overseas talent via the skilled worker visa route.

18. For lower-skill, lower wage roles, an ageing workforce combined with a shift in aspirations among the younger British workforce is a key factor at play. People who

used to do manual, repetitive roles are retiring, and younger British workers have different aspirations to their older counterparts.

19. These shortages have been exacerbated by the end of free movement. EU citizens were more willing to take on manual roles, but fewer are available for work since many European workers left during the Covid-19 pandemic and have not returned given the uncertainty around their rights to live and work in the UK. This has also impacted the availability of seasonal agency labour.

20. Looking across the skills spectrum, the industry suffered from an undeservedly poor image. This was seen as partly due to careers advice in schools promoting office jobs over jobs in manufacturing, driven by a poor understanding of what 21st century high-tech food and drink manufacturing looks like. The rise in remote working since the pandemic has also made it more difficult to promote manufacturing jobs.

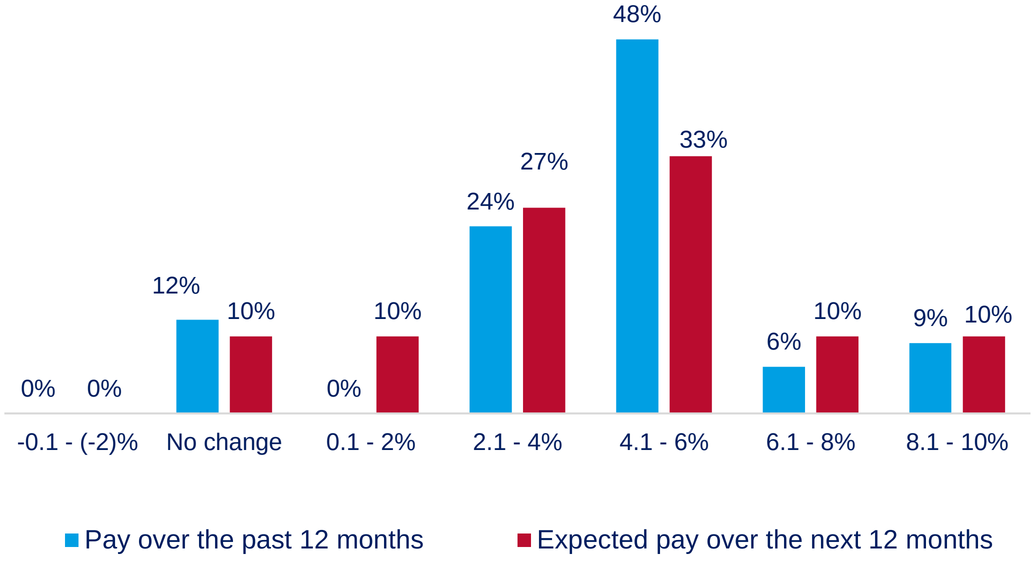
21. In some rural areas, attracting and retaining the best talent can also be difficult. A lack of available, good quality housing and access to public transport such that workers can access rural food and drink manufacturing sites can be particularly challenging when combined with a need to work shift patterns.

22. Members also find it difficult to compete with other sectors for talent. In a highly competitive retail environment, profit margins for many food and drink manufacturers have remained tight, particularly among SMEs, meaning that the sector is vulnerable to competition from other sectors with higher margins. Food price inflation has only exacerbated this – with margins squeezed even further. Small increases in hourly pay in another sector such as large online retailers can be enough to shift people away from food and drink.

What opportunities are there for progression to better-paid work for low-paid workers and how common is promotion?

23. Over the last year, members have faced challenges in retaining staff against the backdrop of a tight labour market and significant wage growth. Employers have worked hard to attract, retain and progress employees. Average pay in the industry increased by 4.1% over the year to March 2023. Half of manufacturers (48%) offered pay rises ranging between 4 and 6% (Chart 2), while a tenth (9%) of respondents awarded rises in the 8 to 10% range. Moreover, the industry anticipates higher rises over the coming year. On average, it's expected wages will increase by 5.4%, with most businesses (33%) projecting rises of 4 to 6%.

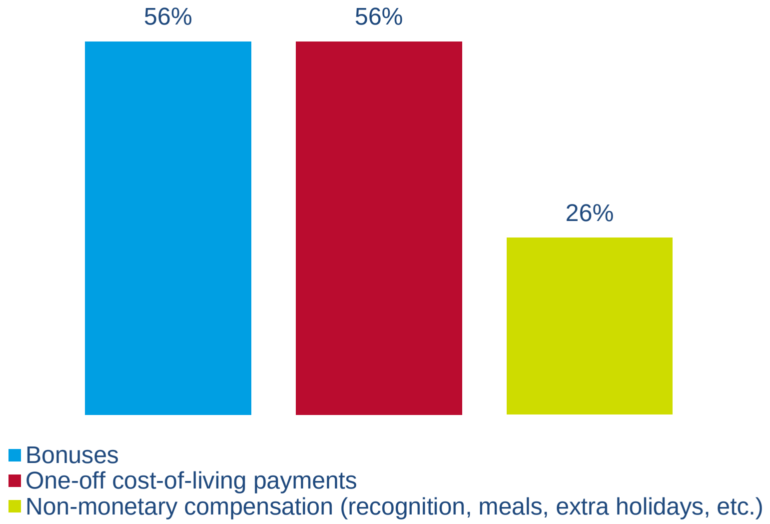
Chart 2: Percent of manufacturers that offered pay increases and expectations of pay rises over the next year



Source: Q1 2023 FDF State of Industry Survey

24. To help their employees weather the cost-of-living crisis and to retain and recruit staff, half of surveyed businesses (56%) offered bonuses over the year to March 2023 (Chart 3), other 56% made a one-off cost-of-living payments and a quarter (26%) have provided some kind of non-monetary compensation (recognition, meals, extra holidays, etc).

Chart 3: Percent of manufacturers that offered other rewards to their employees



Source: Q1 2023 FDF State of Industry Survey

25. In addition to pay rises, bonuses and other rewards, manufacturers have been encouraging internal progression and upskilling through Apprenticeships or more flexible, shorter shift patterns. The have also introduced new training to transition skills across their business e.g., Warehouse to Wheels programme.

Young people

What has been the effect of changes in the minimum wages for young people on their employment prospects?

26. The impact on younger workers has been minimal for the food and drink manufacturing sector as most of our members already pay according to the market and over the rate of the NMW for young people.

27. As is the case in previous years, recruiting young people to replace the ageing workforce remains a priority for the food and drink manufacturing sector. By 2033, it is projected that over a third of our current workforce will be set to retire[3]. Coupled with an insufficient number of skilled individuals to replace these roles this could create a significant problem for the sector if it is not addressed.

28. In partnership with the National Skills Academy for Food and Drink and the FDF, the industry has therefore created and launched the Food and Drink Careers Passport®, an employability tool which provides jobseekers across the UK with the opportunity to gain pre-entry training and accreditation. We have over 75 companies who have pledged support for the Passport (e.g., guaranteeing interviews for passport holders) and 1,000 training opportunities have been created – over 650 committed jobseekers have either started or completed their studies with 400 further places readily available. This is a critical, industry-led tool for bringing young talent into food and drink manufacturing sector.

How do the youth minimum wage rates influence employers' decisions about hiring and young people's decisions about employment?

29. As has been the case in previous years, food and drink manufacturers generally pay based on skill/job band and not age. Therefore, the FDF and our members support the LPC's proposal to lower the NLW age threshold to 21 in April 2024.

Minimum Wages after 2024

Since 2020, the LPC remit for the NLW has been to recommend a rate consistent with reaching the target of two-thirds mean hourly earnings by 2024. They are now gathering evidence to inform the Government's decisions on policy options for the future beyond 2024.

30. The National Living Wage (NLW) and National Minimum Wage (NMW) rates are important considerations to FDF members as it is relevant to the competitiveness of, and employment levels in, the UK food and drink sector.

31. The FDF and its members value the importance of an independent LPC that provides evidence-based recommendations regarding NLW and NMW rates to government. The independence of the LPC is critical to the reputation of the recommendations on the NLW and NMW. The LPC plays a vital role in recognising the need to protect the lowest paid without damaging employment prospects, whilst balancing rate changes against inflation, economic growth and the effect rises would have on businesses

[3] Skills Insights and Labour Market Focus, National Skill Academy Food & Drink, Autumn 2022, pg 15

large and small. Furthermore, employers want clarity on the direction of travel for future minimum wage rates to help inform budget planning – which is usually over a two to three-year period.

32. Specifically on age-related minimum wages, employers in the food and drink manufacturing sector tend to pay all employees the NLW or higher regardless of their age, therefore the removal of the threshold will make little difference in the industry. There are significant labour and skills shortages within our sector - from engineers, food technologists to production operatives. Food and drink companies understand that workplace Equality, Diversity & Inclusion (ED&I) can help address some of these critical shortages as well as improve and strengthen business performance and drive future growth. ED&I is therefore an increasingly important priority for our sector. A balance must be struck between encouraging employers to recruit young talent and making that viable while creating an inclusive workplace where employees are paid according to their skillset and job, not their age.

Apprentices

What is the outlook for the recruitment and employment of apprentices?

33. The recruitment and employment of apprentices is a significant problem across all sectors in the UK. For example, between the 2015/16 and 2021/22 academic years the total number of apprenticeships starts across all standards fell by 37% from 509,400 to 321,400 in England.

34. Experienced workers are leaving our industry for retirement whilst interest from new entrants to the sector has proven limited. It is estimated that almost a third of the food and drink manufacturing workforce is set to reach retirement age by 2033[4]. Food and drink manufacturers have worked closely with the Institute for Apprenticeships and Technical Education (IFATE) to develop standards for Food and Drink Engineer, Food Technologist and Food Process and Technical Operator Apprenticeships. However, the uptake of these Apprenticeship programmes has flatlined or fallen since 2020 and have yet to fully recover back to pre-pandemic levels, with a few exceptions namely Food Engineering (Level 3 and 5) and Food Technologist Level 3 Apprenticeships.

35. We are hiring more apprentices in specific areas where we are facing hard to fill vacancies. The number of young people starting food and drink maintenance engineer apprenticeships increased by 75% and technical operators grew by 25% between August 2022 and October 2022 – the latest data available from IFATE. These are both areas where there are significant skills shortages, demonstrating how apprenticeships are a valuable tool used by food and drink companies to recruit new talent and upskill their people. Additionally, we are unable to access a breakdown of apprenticeship data in other functions of food and drink manufacturing businesses – such as HR, finance and marketing - where we know, anecdotally, there has been growth. Whilst there has been some success with recruiting apprentices, there are a number of barriers which prevent more apprentices being recruited and employed.

36. Challenges in finding new talent externally have led some businesses to encourage internal progression through Apprenticeships which improves skills within the business and encourages retention but does not resolve labour needs. However, the mandatory requirements for functional skills (Level 2 Maths and English) in Apprenticeships is acting as a barrier to upskilling more employees – particularly

[4] Skills Insights and Labour Market Focus, National Skill Academy Food & Drink, Autumn 2022, pg 15

those who are older or have been educated abroad but clearly have sufficient Maths and English skills to be competent in their role.

37. Food and drink manufacturers have made costly adaptions when training apprentices to cover accommodation and travel costs so that they can provide the means of transportation to apprentices to a high-quality training provider. There are geographical gaps in the provision of specialist food and drink apprenticeship standards in England. For example, there is currently no food and drink apprenticeship provision in the North East, parts of the South West and the South East of England. Companies are working closely with apprenticeship providers to develop their food and drink expertise and knowledge about the sector to bring it up to the required level.

38. Members have also made efforts to engage with schools and universities to increase understanding of the jobs available in modern food and drink manufacturing, as well as the wider food chain. Attempts to tackle the industry's image problem by dispelling misconceptions have been made through a number of coordinated careers activity. Initiatives include FDF Scotland food education signposting, National Skills Academy for Food and Drink Tasty Careers campaign, the Institute of Grocery Distribution (IGD) employability programme that includes school visits as well as free learning opportunities for employees in the industry.

39. We are therefore calling for a review of the Apprenticeship System including the Levy which delivers the following:

- A targeted approach to allow more flexible spending within the Levy on shorter, modular training. There is a need to upskill more quickly in some areas (e.g., digital skills, team leader, lean manufacturing) but for Apprenticeship Levy payers, levy costs are crowding out training budgets and this type of training is not being prioritised as it should.

- Greater recognition of relevant experience and prior learning – the mandatory inclusion of functional skills in Maths and English acts as a barrier to apprenticeship participation for older, experienced workers and would be better supported by relevant training outside apprenticeships.

- More investment in training provision to improve the standard and consistency of delivery in all parts of the country. We don't have the same economies of scale that other manufacturing sectors have as we're not clustered in one or two regions so access to high quality, specialist training for our sector is a mixed bag across the country. Training providers and colleges are also struggling to recruit and retain good tutors on current funding levels as they can't compete with salaries in industry. This is impacting both the quality and availability of provision.

- Improved support for SMEs to help them access the right training providers and funding. SMEs who could receive levy funds rarely have the time or resource necessary to access the funds available to them, identify which standards work for them and access the training providers needed to deliver apprenticeships.

How widely used is the Apprentice Rate? What kind of apprenticeships are paid this rate? What kind of jobs do these apprenticeships (paid at the Apprentice Rate) lead to?

40. Many of our larger members do not use the Apprentice Rate, however there are some small and medium sized businesses more likely to use the rate or would consider using it if the decision was taken to remove the other age-related rates in the future.

For example, engineering apprentices may not be fully functioning until their third year when they can add real value to the day-to-day operations of the business. Smaller businesses would seek to use the Apprentice Rate to be able to take on apprentices. After the first two years, engineering apprentices' salaries are gradually increased until they are fully qualified as engineer where they will be fully recognised and rewarded accordingly. If the LPC recommended the removal of the age-related rates as well as the Apprentice rate, the risk could be that even fewer SMEs recruit apprentices.

What would be the effect of removing the Apprentice Rate (so that minimum wages for all apprentices were the same as for other workers of the same age)?

41. While many of our larger members tend to pay above the NMW rates, even for apprentices or young workers, the removal of the apprentice rate could create problems for some of our SME members who use the apprentice rate as young people are gaining in their experience and brought up to the full salary band when they have reached a certain level of proficiency through their apprenticeship. These businesses which are already struggling with pay differentials, have said they would be unable to keep up with the age-related bands, especially in relation to apprentices that may be in the 18–20 year-old band.

Compliance and enforcement

What issues are there with compliance with the minimum wage and what could be done to address these?

Salary sacrifice

42. The FDF would like to see salary sacrifice included in the National Living Wage. The knock-on effect for larger companies is that in order to comply with NLW requirements they have to remove the lowest paid employees from these schemes meaning that neither the employee nor employer can benefit from reduced NI contributions under salary sacrifice. Additionally, this creates a disincentive to contribute into other benefits such as pensions.

Shift premium

43. Shift premium is a common part of employee contracts in many food and drink manufacturing companies; it is as embedded within contracts as other common benefits such as pension contributions.

44. Given the prevalence of shift premiums within our sector, the FDF is disappointed that an allowance for shift premium is still not included in NLW and NMW calculations. As NLW and NMW rates continue to go up, food and drink manufacturers increase their shift pay to maintain pay differentials between employees who work unsociable shifts and those who do not. This in turn creates an additional pressure on employment costs which, if not addressed, could lead to a decline in shift premiums as employers become unable to pay the premiums to maintain pay differentials.

What comments do you have on HMRC's enforcement work?

45. The FDF supports the efforts of HMRC to enforce compliance by taking firm action against deliberate and persistent non-compliance and providing guidance to employees. Not only is this the right thing to do for workers affected, it prevents the undercutting of compliant businesses and ensures a level-playing field in the market.

46. The FDF is encouraged by Government's approach to enforcement such as greater leniency for unintentional non-compliance, more regard to how salary sacrifice schemes are used, improved guidance for companies and the increase to the threshold for 'naming and shaming'.

Accommodation Offset

What has been the effect of recent increases in the offset on employers' decisions over providing accommodation?

47. Use of the accommodation offset is not common in food and drink manufacturing. However, it may be used more widely by food and drink manufacturing suppliers and we would urge the LPC to be mindful of submissions from these sectors in relation to potential impacts on wider food and drink supply chains.

Economic Outlook

48. The last years have been incredibly turbulent, with three structural shocks in quick succession: Brexit, the pandemic and the war in Ukraine. And while all UK economic sectors felt some adverse impacts, the food and drink manufacturing was disproportionately impacted.

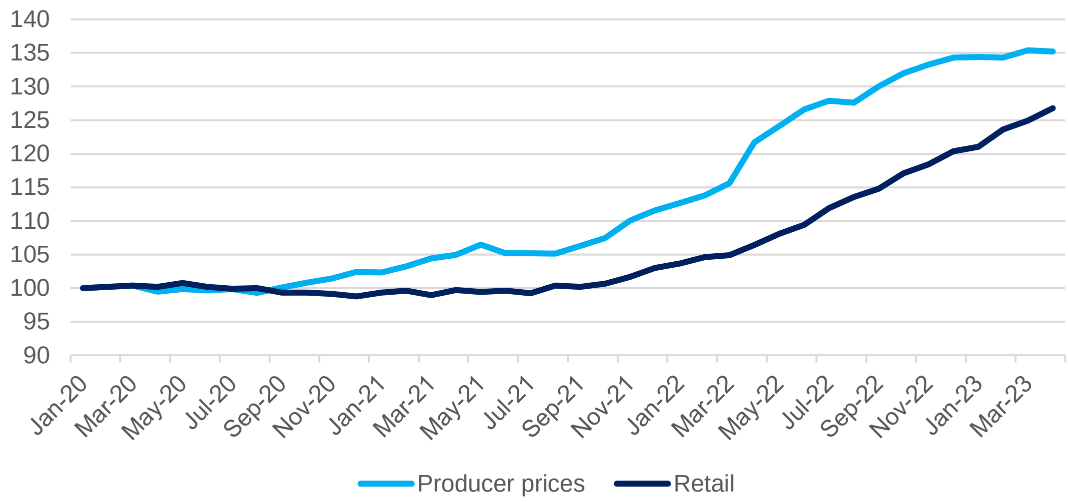
49. Brexit increased the red tape involved in trading with the EU, effectively raising the costs for trading with the continental bloc.

50. The pandemic shock meant that manufacturers had to adjust quickly to supplying supermarkets and shift away from the hospitality industry, and then to reverse this in the span of two years. Moreover, the global change in consumption from services to goods wreaked havoc in global logistics and supply chains, against a backdrop of rising prices of agricultural commodities due to increased Chinese demand and adverse weather patterns. In the UK, the pandemic also disrupted the labour market, with severe labour shortages posing a serious challenge to businesses.

51. The war in Ukraine severely disrupted global food supplies, as Ukraine and Russia were significant global suppliers of wheat, other grains and sunflower oil. As Russia cut its gas supply to Europe, energy prices skyrocketed, along with fertiliser prices (main fertilisers are a by-product of gas production).

52. All of the above means that food and drink manufacturers have seen over two years of substantial upward pressures on all cost elements of the industry, from ingredients and packaging to labour, transportation and logistics. Producer prices (input costs) started rising in October 2020 (Chart 4), and by April 2023 they were 35% higher than in September 2020. It's noteworthy that while costs appear to have stabilised over the past couple of months, they have not started to decline.

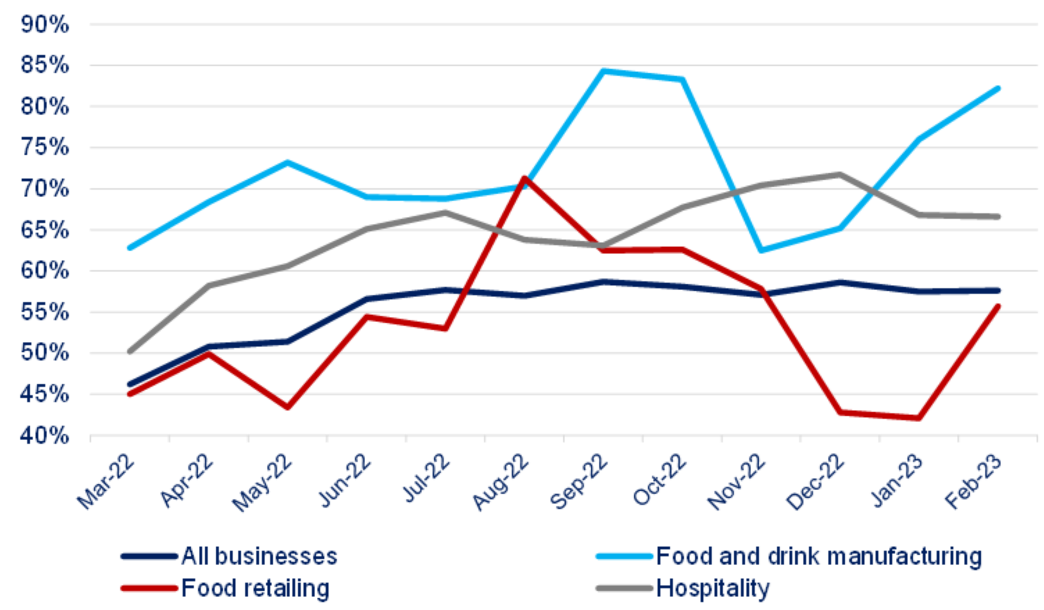
Chart 4: Food and drink producer prices and retail prices
Index, Jan-20 = 100



Source: ONS

53. Faced with this barrage of cost rises, food and drink manufacturers dealt with pressures in a variety of ways. They reduced product ranges, became more energy efficient, switched suppliers, cut back on marketing and training spend, and paused or cancelled investment. They also absorbed a share of the costs (Chart 5). It's important to note that more manufacturers seemed to have absorbed costs than food retailers or hospitality outlets. On average, over the past year to February, 72% of food and drink manufacturers absorbed a share of rising costs, compared with 56% of all UK businesses, 53% of retailers and 64% of restaurants and cafes. This is another indication of the disproportionate impact of the recent challenges on the industry.

Chart 5: Percent of businesses that stated they absorbed costs



Source: ONS, Business Insights and Conditions Surveys, March 2022 – February 2023

54. Recent challenges have almost completely eroded the resilience of the industry. The most obvious piece of evidence is the significant rise in insolvencies in the sector. In 2022, there were 244 insolvencies in the food and drink manufacturing, up from 122 in 2019, so a rise of 100% (Table 2). That compares to a rise of 25% in Great Britain. This worrying trend is likely to continue, with 71 insolvencies already recorded during the first quarter of the year. This amounts to 58% of 2019 insolvencies. In contrast, in Great Britain the total insolvencies in Q1 represented 38% of the 2019 insolvencies.

Table 2: Number of insolvencies

	2019	2020	2021	2022	Jan-Mar 2023
Great Britain	18204	13276	14810	23189	6257
Food manufacturing (GB)	95	94	64	173	46
Drink manufacturing (GB)	27	30	18	71	25

Source: The Insolvency Service

55. The short-term outlook for the industry is concerning, with the biggest near-term challenge being the ability to pass on cost increases. Cost pressures on the industry are subsiding, albeit slowly. Wholesale energy costs have been in free fall since December, reaching now levels about 15% higher than pre-pandemic. Global food prices have been on a downward trajectory, in May being 22% below their March 2022 peak, with all subindices, except sugar, having fallen. Nevertheless, compared to February 2020, global food prices remain 25% higher. International shipping disruption has now largely dissipated, as reflected in the price for international cargo which now have returned to their 2019 levels. Labour vacancies remain uncomfortably high (as point 15 above illustrates).

56. However, there is a lag of seven to twelve months between changes in manufacturers' costs and changes to prices on shop shelves. Retail prices tend to move slowly relative to underlying raw material costs. The time lag which exists between commodity prices and retail prices is often the result of fixed-term contracts with suppliers (forward buying) and the use of futures contracts traded on commodity exchanges (hedging). Food manufacturers can lock in commodity prices for up to 12 months, long enough to cover a season of bad weather, but short enough for underlying demand changes to feed through. At the same time, this protects consumers from price volatility. Table 3 illustrates how retail inflation lags behind increases in producer costs. In 2021, producers' costs rose, on average, by 5.7%, while retail prices only increased by 0.3%. In 2022, costs continued to climb by 17.8%, but retail prices went up by 11.0%. This lag can clearly be seen in Chart 5 too.

Table 3: Yearly changes in food and drink producer prices and retail prices

	All inputs into the production of food and drink	Imported ingredients	UK-sourced ingredients	Food and non-alcoholic drink retail prices
2019	0.8%	3.2%	0.0%	1.4%
2020	0.8%	1.7%	1.1%	0.7%
2021	5.7%	0.6%	6.0%	0.3%
2022	17.8%	21.3%	16.2%	11.0%
Jan-Apr 2023	16.4%	27.6%	14.4%	15.6%

Source: ONS

57. As production costs can only be recovered with considerable delays due to fixed-term contracts, manufacturers have more increases in costs that they need to pass on to consumers. Nevertheless, the decline in real wages over the last year and significant focus of the public on the alleged profiteering suggests that manufacturers will find it difficult to pass on the necessary cost rises to rebuild some of their margins and focus on future growth.

58. And growth in some subsectors has slowed recently (Table 4). In Q1, compared to a year ago, output of the food manufacturing was 1.5% smaller than a year ago, with the following subsectors also shrinking: fish, fruit and vegetables; dairy; grain mill and starch products; and other food products.

59. As the cost-of-living crisis hit British households hard, this is not surprising. Worryingly, many people are dealing with the rise in prices by buying less food, with about half of the population reporting lower food purchases over the last year, compared to fewer than 10% in October 2021 (Chart 6).

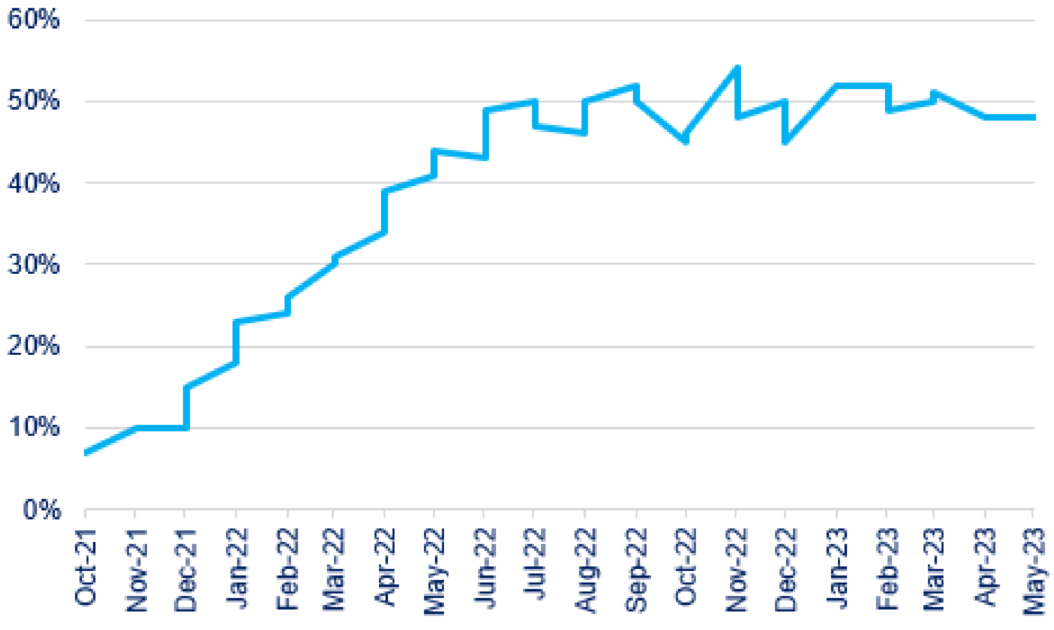
60. The combination of lower demand and inability to pass on cost increases is likely to push many smaller producers out of business. Smaller companies have little negotiating power with supermarkets, leaving them more vulnerable to general market conditions. Findings from Q1 2023 FDF State of Industry survey show that smaller firms absorbed a larger share of cost rises than larger companies. On average, reported total costs increased by 15.4%, while their selling prices rose by 12.5% only. By business size, changes in costs and prices respectively are the following: larger companies (turnover: £500m+): 15.7% and 13.0%, mid-size companies: 12.8% and 7.2%, while smaller companies (turnover: <£25m): 10.7% and 4.6%.

Table 4: Food and drink manufacturing growth by sector, Q1 2023
Gross value added (GVA), chained volume measures

	Q1 2023 on Q4 2022	Q1 2023 on Q1 2022
Food manufacturing	**0.1%**	**-1.5%**
Meat and meat products	1.0%	2.8%
Fish, fruit and vegetables	1.4%	-1.5%
Vegetable and animal oils and fats	-26.7%	-15.4%
Dairy products	-0.6%	-1.6%
Grain mill and starch products	-1.3%	-4.1%
Bakery and farinaceous products	2.1%	3.0%
Other food products	-2.1%	-7.3%
Non-alcoholic drink manufacturing	**3.6%**	**0.6%**

Source: ONS

Chart 6: Percent of adults stating they are buying less food



Source: ONS, Opinions and lifestyle surveys

61. For the medium- and longer-term outlook, subdued investment and climate change are the main challenges. Investment in the industry has been on a downward trajectory since Q3 2021, with about 60% of manufacturers reporting in Q3 that they had to pause or cancel investment projects to be able to deal with ongoing cost pressures. A fall in investment will mean a contraction of the UK food and drink sector. A slow economic recovery (which would not allow consumer spend to recover) and poorly designed government regulation, such as the Extended Producer Responsibility, will further inhibit growth.

The UK Food and Drink Manufacturing Industry

The Food and Drink Federation (FDF) is the voice of the UK food and drink manufacturing industry, the largest manufacturing sector in the country. Our industry has a turnover of more than £113 billion, accounting for 20 per cent of total UK manufacturing, and Gross Value Added (GVA) of more than £33 billion. Food and drink manufacturers directly employ over 450,000 people across every region and nation of the UK. Exports of food and drink make an increasingly important contribution to the economy, approaching £25 billion in 2022, and going to over 220 countries worldwide. The UK's 12,460 food and drink manufacturers sit at the heart of a food and drink supply chain which is worth £116billion to the economy and employs 4.3 million people.

The following Associations actively work with the Food and Drink Federation:

ABIM	Association of Bakery Ingredient Manufacturers
BCA	British Coffee Association
BOBMA	British Oats and Barley Millers Association
BSIA	British Starch Industry Association
BSNA	British Specialist Nutrition Association
CIMA	Cereal Ingredient Manufacturers' Association
EMMA	European Malt Product Manufacturers' Association
FCPPA	Frozen and Chilled Potato Processors Association
FOB	Federation of Bakers
GFIA	Gluten Free Industry Association
PPA	Potato Processors Association
SNACMA	Snack, Nut and Crisp Manufacturers' Association
SSA	Seasoning and Spice Association
UKAPY	UK Association of Producers of Yeast
UKTIA	United Kingdom Tea & Infusions Association Ltd

FDF also delivers specialist sector groups for members:

Ice Cream Group
Organic Group
Seafood Industry Alliance
CBD Group