Paper contribution to the EBN seminar
Competitiveness of Agriculture in Central and Eastern Europe over the next 25 Years. Likely consequences for the Dutch agribusiness
The Hague, 26 May 2005

Threats and Opportunities for the Dutch Agribusiness

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Introduction

It is an honour for me to be invited to speak at this seminar to such a broad audience. The other speakers have focused on major trends in the competitiveness of the agricultural sector in Central and East European countries. It is my task to introduce to you the implications of the developments in the East for the Dutch agribusiness.

The outline of my talk is the following. The presentation starts off by briefly reviewing the present characteristics of the Dutch agribusiness. It further identifies some of the major trends in the Dutch positions on its most important markets. The picture is not always positive – some market positions decline - and I will briefly indicate the reasons for this by focusing on policy changes as well as on market developments. Next, I turn to developments in the Central and Eastern Europe and depict the features of the food markets in the region. I will make clear that the developments in CEECs will offer the Dutch agribusiness opportunities for increased outlets but – as food markets in Central and Eastern Europe further develop – competition in the region is expected to intensify. This presentation highlights the present position of the Dutch agribusiness in Central and Eastern Europe. In my conclusion I briefly indicate Dutch opportunities in Central and East-European markets and how the Dutch agribusiness might (be able to) react most effectively to these opportunities.

Features of the Dutch Agribusiness

The Dutch agribusiness has several advantages. These advantages support the sector in its international competition. First, the sector takes advantage of favourable physical circumstances for agricultural activities. The country’s climate is benign and soils are good. The country is densely populated and consumers have a high purchasing power. Moreover the country is situated close to large markets in Northwest Europe. The primary sector consists of well-educated farmers, who took advantage of a long history of close cooperation between the sector on the one hand and the research, extension and education services on the other. Moreover, the primary sector has a long history of horizontal coordination, being represented in the policy arena by their pressure groups and by joining forces as cooperatives in the market. The latter form of organisation has also encouraged vertical coordination in the market, strengthening the interrelationship between supplier and processor. The industry can be characterised as modern and sophisticated, able to exploit the high quality raw material of the primary sector. This combination of well-educated farmers and modern industries makes the Dutch agribusiness highly productive and efficient. The Dutch agribusiness is export oriented: some branches export half to three quarters of their production, mainly to nearby, other EU Member States. The Dutch agribusiness is also a large foreign investor: foreign assets owned by the Dutch agri-food companies represent about 30 billion euro in recent years.

There is, however, an important disadvantage. Land prices are high. This hampers structural improvements in the primary sector. Also, labour is relatively expensive and adds significantly to production costs in labour-intensive horticultural sectors.

Another feature of the sector is its declining position in the national economy. The contribution of the Dutch agribusiness to the national income has declined from 12% in 1995 tot 10% in 2003. Next to the primary sector, the agribusiness complex consists of upstream and downstream industries, and the distribution. Within this complex, the position of the primary sector deteriorates. The share of the primary sector in the total value added of the whole agribusiness complex has declined over time to reach now a mere 20%. These tendencies are normal in developed market economies, which are increasingly service economies, and where consumers increasingly demand pre-treated and processed food products. What is further ‘typical Dutch’ is that an increasing share of the value added by the agribusiness is based on the import of foreign raw material, from 35% in 1995 to 40% in 2003. This indicates the dependency of the Dutch food processing industry on imports. On the whole, however, the agribusiness has performed less successful than those in other EU countries: the growth in value added is less than half of the average growth in the EU15 over the last decade.

The rather disappointing performance of the Dutch agribusiness in recent years is also reflected in the analysis of its position in major markets. The general picture is that the Netherlands has lost market shares in the EU, most prominently in the meat markets and in the vegetable market. However, there is no reason for acute despair: Dutch shares in the EU are still very large for most agricultural products such as potatoes, flowers, vegetables, dairy products, pork and poultry. For all these product groups, the Netherlands is the major or among the top three suppliers of EU imports. Yet, the other thing is the way the Dutch agribusiness competes in international markets: mainly by following a strategy of price competition, offering good quality products at competitive prices in large quantities, but nothing special. Recent studies by the Agricultural Economics Research Institute LEI on the competitiveness of the Dutch agribusiness indicate that the continuation of a strategy of price competition is extremely difficult as increasing costs of production cannot be adequately compensated by increasing scale of production, and other cheap producers enter the market. Examples to illustrate this can be found in the German market where the Netherlands lost share of the vegetable market to Spain, of the mushroom market to Poland and of the cheese market to Denmark and Austria. At the same time, the discerning consumer appreciates variation, high quality, and increasingly takes into consideration other product attributes than price. Our analyses indicate that only a few efforts to compete with differentiated products were successful, and that the Dutch product assortment is generally too narrowly differentiated to maintain its market shares in significant markets.

A further shift to a strategy of product differentiation is necessary to comply with the requirements set to the agribusiness to survive in the international competition. Several issues are important in this respect. I summarise them as policy and market developments. First, policy developments in the last decade show less focus on production and farm income, and more on demands of consumers and society. Such demands are, for instance, important in the area of environment. Policies that support society's demands in this area are extremely important to agriculture. Here I mention the Nitrate Directive and the Water Directive. The national measures based on these Directives lead to further constraints on agricultural production in a highly densely populated country like the Netherlands. Such constraints force the primary sector, as well as the processing part of the agribusiness complex, to come with innovations in the area of production methods and marketing of products. Furthermore, cross-compliance is an important element of the new CAP, linking direct income support to requirements in the field of protection of the environment and animal welfare. Price support, the traditional instrument of the CAP, has already lost its position and will further decline in the years to come, among others under pressure of WTO-rules. Changes in agricultural support policies lead to changes in relative prices and production, which affect the competitiveness of the whole agribusiness complex.

Second, market developments also force the agribusiness to alter its strategy of competition. I already indicated the changes in consumer preference to pay more and more attention to other factors than price, such as quality, convenience, flavour, appearance, health, and method of production. Also, with a rather modest economic growth in the already saturated markets in Northwest Europe – the major markets for Dutch agribusiness – competition is extremely tough. Product differentiation is then a strategy offering much more prospect than the continuation of price competition strategy. Large companies – processors and supermarket chains – are increasingly dominating the international food markets. Such companies apply the concept of 'global sourcing'. In order to be of interest to their supply and marketing networks, companies as well as their suppliers (farmers) have to offer products and services of distinctive features at highly competitive prices.

The Agribusiness Sector and Food markets in Central and Eastern Europe

I now turn to the agribusiness sector in Central Europe and briefly review some of the major developments in this market. First, I have a look at the supply side. The first years after the fall of the Berlin Wall showed a rapid decline of agricultural production, due to a breakdown of institutions, companies and farms. It took six to seven years before the first signs of recovery appeared; first in countries where reform programmes were implemented most drastically, like in Poland, while sector performance improved a few years later in the 'slow reformers' like Slovakia and Romania. At present the production value of the agribusiness sector in the ten New Member states plus Romania and Bulgaria is around 6% of the EU15, which is the same as the Dutch share. The restructuring process of the agriculture and food industry in Central Europe is not finished yet: the primary sector is still fragmented in most countries, and lacks knowledge and financial means for investments to improve product quality. The processing industry in most countries in the region is still highly fragmented in most branches and huge investments are necessary to comply with the requirements set in the *Acquis Communautaire* (EU legislation) and to compete with foreign companies. Many of the smaller companies in the region will not survive in this process. My assessment is, therefore, that competitiveness of the local agribusiness is relatively low and it will take many years to improve that situation.

Viewed from the demand side, the food markets in Eastern Europe provide good prospects. Generally, per capita consumption of food and beverages is well below the EU15 average. For instance, figures for the year 2000 indicate that meat consumption per capita in Poland was 70% of that in the EU, while milk consumption in that country was only 50% of the average EU level. Yet, the expectations are generally positive as income is expected to grow and prices to go down. Similar as in Western European markets today, consumer patterns of food will increasingly be determined by health consciousness and convenience. The question is: who will supply the increasing demand for food in the region? At present, all countries except Hungary are net-importers of agricultural and food products. Despite the great potentials of the agricultural sector (and different to previous studies in the nineties) most recent projections by the EC and other international organisations do not expect a rapid increase in agricultural production in the region. Therefore, foreign companies may find good prospects for growing markets in the region.

Having said this, food markets in the CEECs are, however, not to be considered easy markets. An important development in recent years has been the rapid penetration of large West European supermarket chains in most countries in the region. Figures for the year 2003 indicate that in Hungary and the Czech Republic around 50% of the food sales are sold through the supermarkets and in Poland over 30% (compared to 70-80% in Western Europe). This development has several important implications. First, it pushes forward the process of greater conformity in consumer behaviour in Europe, as these supermarkets pursue similar shop formulas in their shops in Western and Eastern Europe. Second, it pushes forward the process of increasing emphasis on quality, and other product attributes, calling for product differentiation of their suppliers. The supply chain has to invest in these matters and innovate. For innovations toward a successful strategy of product differentiation, processing companies are looking for scale economies, for instance through take-overs and mergers. The result will be a further consolidation in the food processing industry in the region.

The Position of the Dutch Food Industry in CEE

Now, what is the position of the Dutch food industry in Central and Eastern Europe? Many companies have entered the region since 1990. Most companies started with trading activities. Some companies turned to direct investment in local production as a strategic decision to increase market shares in the region. The Dutch agribusiness has exploited their opportunities in a wide range of food branches. Not all efforts were successful – I shall not mention specific cases – but a number of Dutch food companies have achieved significant market shares in the region.

The position of the Dutch agribusiness can be illustrated by some general figures. Of all food imports by the CEECs, the Netherlands supplies around 6%. This is an overall figure and the position differs between countries. For instance, the Dutch agribusiness offers around 10% of the total food imports in Poland. Furthermore, the Dutch companies are active investors in the region. In practically every country in the region, the Netherlands is mentioned as one of the major sources of foreign direct investment in the local agribusiness.

The Dutch trade relations are most intensive with the largest market in the region, Poland. Exports valued up to around 370 million euro in 2003 (figure 1). This is the same as the total sum for the other three major markets: the Baltic countries, Czech Republic and Hungary, which are equally important export markets for the Netherlands. It should be noted that the Netherlands also imports agricultural products from these countries in substantial amounts. This underlines the Dutch position as a trading nation.

Dutch investments in the region have increased rapidly after the fall of communism. In 1991 investments accounted for no more than a total 30 million euro. This amount increased more than tenfold, up to 400 million euro, by 1995 and has reached over 3 billion euro in 2003. This is almost 12% of all investments of the Dutch agribusiness abroad. Poland has received most of the investments, followed by Hungary and the Czech Republic (figure 2). These three countries are the larger economies in the region. In addition, these countries showed in the mid-1990s an economic and political environment sufficiently stable for foreign investors to come in. Since 2000, Dutch investments in Russia have increased considerably. These investments came in after the country had recovered from the economic ‘rouble’ crisis in 1998/1999 and the country seemed politically more stable than before. The trust that foreign companies have in investing in Russia might, however, have been modifies since the Yukos affair started last year.

Conclusions

I now come to some conclusions. What about the opportunities for the Dutch agribusiness in Central and Eastern Europe? I am not going to be very specific here, but will indicate what, in my opinion, is most important. My first remark is that the point of departure seems favourable. The Dutch companies are internationally oriented and have shown to be internationally competitive in the European market for many agricultural and food products. Many companies have been active in the East European countries, either as a trading company or as a local investor, and have gained a generally reasonable market share in the region. Some are even ‘big players’ in a local market. However, - and this is my second remark - the CEE region will be a mature market in the not too distant future, where consumers will be demanding for quality products at highly competitive prices. In the medium run consumers in Central and Eastern Europe will appear such as those in the West European markets. Income developments are of course very important in this process, but the impact of the supermarket chains on consumer behaviour is important too. As in West European markets, competition in the countries in Eastern Europe is increasingly focused on distinction: as a supplier one has be ‘special’ and has to distinguish oneself from competitors.

The strategy for the Dutch agribusiness to pursue opportunities in a growing food market in the East European region is, therefore, not different from the strategy that offers the best perspectives for maintaining market shares in the west. That strategy is to stand out: to offer products that cannot be offered by someone else. To offer products that comply with consumer demands, to quickly adapt to changing consumer preferences when these are noticed, and to provide optimal services to their customers. Such services are to deliver a stable supply on time, both in terms of quality and quantity. Those who are successful in this strategy will have the best prospects in the large European food market in the years to come.

Figure 1 Dutch Trade position with CEE Trade Partners, 2003 (million euro)

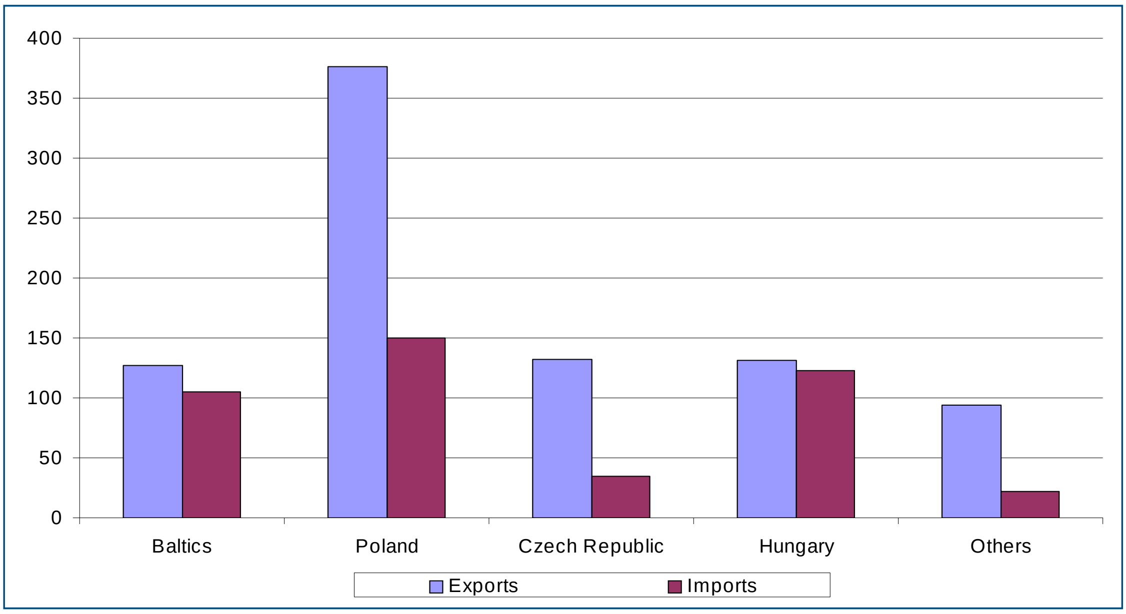

Figure 2 Dutch Investments in Agribusiness in Easter Europe, 1995-2003 (million euro)