The stakes of globalisation for food-processing companies

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European food-processing companies are growing at a slow rate in Europe where they are under great pressure from the retail sector to keep prices down. To grow, they are developing new segments, either in terms of their product offers (health issues, practicality; etc.) or in their distribution channels (the food service sector, for example). This strategy is costly and often does not produce the results expected, at least in the short term. Moreover, their strategies for increasing market share and concentrating the industry at national level are beginning to show their limits.

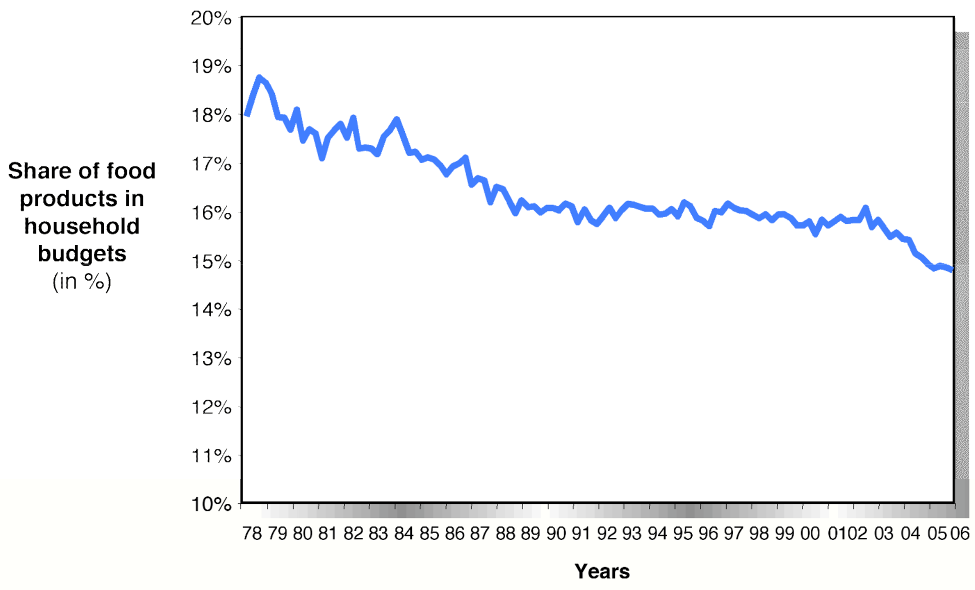
Consequently, international development in emerging countries offers opportunities to copy the models that made the success of these companies in the past 20 years. However, there are many obstacles to this international strategy.

Low growth of the food sector in the developed countries

At macro-economic level, food is, along with clothing, one of the sectors whose share in household consumption is declining structurally. Between 1978 and 1992, it lost 2 consumption points; between 1992 and 2006, it lost 1 point, particularly since 2000 (cf. table 1).

- Table 1 -

The share of food in household budgets has declined for 25 years
(France – in euros)



Growth in this category in household budgets between 1959 and 2000

- Food	**-13 ppt**
- Alcohol and tobacco	-3 ppt
- Ready-to-wear	-6 ppt
- Housing	13 ppt
- Electricity and gas	0 ppt
- Furniture	-3 ppt
- Health	2 ppt
- Transportation	5 ppt
- Communication	2 ppt
- Leisure and culture	2 ppt
- Education	0 ppt
- Hotels and restaurants	0 ppt
- Other	1 ppt

Source : Estin & Co analyses and estimates

Several factors explain this trend. New needs requiring a reallocation of budgets have developed rapidly, such as telecommunications, health and well-being. Moreover, the retail sector has increased its pressure on prices with its suppliers and passed on part of these savings to consumers.

Finally, the consumers' behaviour is now focused on two aspects: the segment of down-market products has grown, thanks to the development of hard discounters, lowest price ranges and own brands; while new needs for value-added products combining health benefits and practicality have also grown but in volumes that are still limited. Overall, the "core market" for "traditional" food brands has diminished.

Significant growth in the emerging countries

Simultaneously, the emerging countries are undergoing profound changes in their food consumption patterns, leading to rapid growth in these markets.

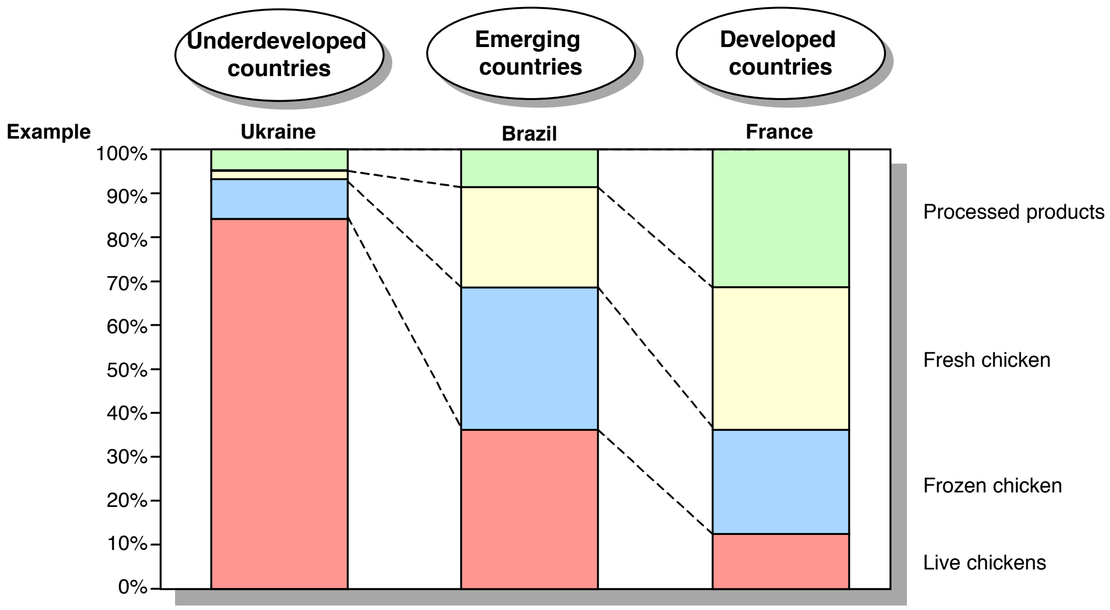
For countries with a low living standard (gross GDP per inhabitant under 5,000 euros), food consumption is mainly based on unprocessed products (cooked at home) and basic ingredients. So the growth potential of the food-processing industry is low.

But the emerging countries with a medium standard of living (between 5,000 and 15,000 euros) are developing new needs thanks to the adoption of kitchen appliances (particularly ovens, fridges and freezers). Processed products are developing, principally in primary processed products. In the chicken market, for example, the supply of packaged products has overtaken that of live chickens (cf. table 2). Moreover, frozen products are on the rise, thanks to supermarkets, as they enable consumers to reduce the frequency of their purchases. The majority of sales are focussed on a limited number of products. This development stage offers a real opportunity to European companies. In dairy products for example, the emerging countries show annual growth of over 10%, in Eastern Europe (Ukraine, Romania, Russia), South America (Mexico and Brazil) and Asia (India and China).

- Tableau 2 -

Emerging countries are experiencing deep changes in their food consumption habits

(France – in euros)



Source : Estin & Co analyses and estimates

International development: global growth for food-processing companies

Consequently, the European groups that have experienced significant growth between 2000 and 2005 often owe this to their dynamic international growth.

Danone, for example, has had an annual growth rate of 5% over the last 5 years. This breaks down as a low growth rate of 3% per year in the developed countries compared to 9% per year in the emerging countries.

Similarly, 45% of Heineken's growth in recent years is due to its development in the emerging countries.

Inversely, many national companies have achieved low growth insofar as they remain focussed on their national market.

A food-processing company must develop its model beyond its borders or risk weakening its overall position.

The obstacles to international growth

But there are obstacles to this strategy, either at supply level or in terms of the economics of this development.

The food market shows wide cultural differences. Consumer habits vary from one country to the next, with equivalent economic development.

For example, there is a relationship between economic development and the average consumption of yoghurt per inhabitant. However, there are some exceptions: Turkey has the highest consumption rate in the world. Inversely, the English-speaking countries have low consumption rates. In ice cream, New Zealand's rate is 5 times that of Spain, which has an equivalent GDP per inhabitant.

Moreover, the nature of food products varies between countries. France and Italy have a high rate of consumption in cheese (around 25 kg per inhabitant). In France, soft cheeses predominate (camembert, brie, etc.) whereas hard cheeses (mozzarella) are predominant in Italy. Hence adaptations are necessary.

The cost of this development for companies is high at different levels.

At industrial level, the wide disparities in terms of products prevent producers from obtaining the full benefit of economies of scale and series. The transport costs of fresh products make production concentrations difficult, requiring the development of local production units with local sourcing (and consequences in terms of hygiene, quality, etc.) and the transfer of industrial expertise to these countries (with the implementation difficulties that these entail).

At commercial level (sales forces, marketing, advertising, local structures), economies of scale are crucial. Cost effectiveness is achieved only with a critical rate of turnover. So companies need to have the resources (and the patience) to grow and make these investments cost effective.

At financial level, these developments involve a level of risk that small or over-specialized companies cannot afford. The economies of the emerging countries are growing in structural terms but with periods of sharper downturns than in the developed economies. A company needs to be sufficiently large (and with a large portfolio of products and countries) to be able to absorb such variations.

What should we conclude?

The development of food-processing companies in the emerging countries requires an approach based on a careful selection of geographic spread, a carefully planned entry, and a precise definition of the product range, enabling the company to capitalise on its experience while adapting it to these new markets.

To succeed, companies have to move away from the classic solutions adopted on their national markets. Internationalisation necessitates a certain critical mass. Groups such as Fleury Michon, Bigard and Bonduelle will have to become international if they are to continue to grow.

Hence the need for alliances, mergers or partnerships between food-processing groups in *related* segments. For example, chicken companies can team up with companies producing cooked dishes, and cheese manufacturers can widen their international base through the greengrocer sector. The first groups that develop such approaches will be the ones that will survive …