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HD **Industry Insight Industry comment by Peter McGregor Commonwealth Bank Managing Director, Industrials, food and beverage and agriculture**

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Australia's food and agriculture businesses are benefiting from the strong and growing demand for food supply and food security from the Asia-Pacific region, led by **China**.

New and largely favourable patterns of consumption are being driven by the pairing of the two important trends of massive population growth and substantial increases in prosperity.

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The opportunity for the Australian food and beverage sector to tap into this demand, and related commercial success, has not gone unnoticed in the region.

There is a continuing focus from Asian companies and investors who want to **acquire** assets in Australia, with a significant number changing hands in the last three years.

For many local producers there is a natural temptation to believe success in the domestic market will automatically translate into success overseas. But of course, it is never that easy.

Instead, as Gary Helou, managing director of Devondale Murray Goulburn explains, success really comes from staying focused on the customer.

"Devondale Murray Goulburn generates just over half of its revenues from exports. We're successful because we're focusing more on the actual needs of customers and consumers in our target markets. We focus on these local consumption opportunities as we build better connected manufacturing and supply chain capabilities to deliver the right **dairy** food products to suit these emerging and high-growth international markets. That is different to the conventional selling posture of simply looking to offload surplus local manufacturing capacity to export markets," he says.

"Today about $38.2 **billion**, or 15 per cent, of Australian trade comes in the form of food and beverage. **China** and Japan alone constitute about a third of the total," says Adnan Ghani, global head of trade at the Commonwealth Bank.

China in particular is growing strongly, with Australian agricultural exports doubling between 2010 and 2013 from $3.5 **billion** to $7 **billion**.

But the idea that it is relatively simple for Australia to satisfy the food shortage issues expected in **China** over the next 20 years is difficult to sustain when you consider the practicalities.

The level of investment needed to achieve such a goal is almost incomprehensible. For instance, Australia's annual production of the world's three main grain crops – wheat, corn and barley – represents only about 2 per cent of world output.

The real opportunities may emerge from developing successful niches, and there is plenty of evidence Australian companies are growing their strength and capabilities around this strategy.

For example, while grain exports from Australia are the same today as two years ago, powdered **milk** exports are 50 per cent up over the same period, which speaks to the success of companies such as Devondale Murray Goulburn.

"These sorts of niche markets where we genuinely have a competitive advantage can be hugely lucrative," Mr Ghani says.

The most successful companies we see are focused on finding great local partners and developing emerging markets rather than simply trying to boost local production in the hope that new markets can later be secured.

The announcement by New Zealand's Fonterra that it has taken a significant **stake** in a Shanghai based **dairy business**, is a good example of this approach.

Of course trade has always come with risks, which is where solid commercial partners as well as strong local partnerships are especially important.

At a macro level, the biggest risk for many companies is simply not being able to meet the growing customer demand. Finding the funds to meet that demand will also continue to be a real challenge.

For example, the Commonwealth Bank and Devondale Murray Goulburn recently entered into an arrangement where CommBank funded the costs of two new production facilities to be operated by Devondale Murray Goulburn under a long-term leasing arrangement.

This lets the **business** fund its production out of cash flow rather than finding the money up front.

Regulatory impediments are another risk, as Archer Daniels Midland found when its bid to take over GrainCorp was blocked.

These issues raise questions about whether Australia has the right policy settings and ownership structures to encourage the investment needed to grow the supply over the long term.

Within the food and agriculture sector we also see different types of challenges for large companies, compared with the mid-tier and smaller businesses.

"For larger businesses it's about partnering with different stakeholders to manage risks and about creating process efficiencies," Mr Ghani says.

Mid-tier companies also worry about managing risk, but they focus on issues of working capital and finance as well.

"There is a great opportunity to help customers through trade finance because from a capital perspective, trade finance has relatively lower capital costs than other forms of financing," he says.

Peter McGregor is Commonwealth Bank's managing director, industrials, food and beverage and agriculture.

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