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The evolving EU–Africa dairy trade: EU corporate responses to milk production quota abolition

Contents

Summary

The expectation of expanded EU milk production after the abolition of production quotas in 2015 is leading major EU dairy companies to explore investment and market opportunities in Africa. Increased EU engagement in African dairy sectors could support or undermine the structural development of African dairy sectors and the development of local milk supply chains. Given the forecasts for expansion of EU milk powder exports, government policies on the regulation of milk powder imports and the strengthening of local supply chains could prove important in determining the structural impact of growing EU corporate interest in African dairy sectors.

EU policy and the global dairy market context

The EU's CAP reform process cannot be divorced from the changing structure of global demand for agro-food products. Since the early 1990s, the EC has recognised that global demand growth would drive agro-food product markets. Policy reforms were therefore designed to equip EU agro-food sector enterprises to compete more effectively on global markets.

With reforms of the EU dairy sector reaching their final stage of implementation, EU dairy companies are increasingly gearing up to serve expanding global markets for dairy raw materials and value-added dairy products, trading strongly on the reputation of EU dairy products for quality and safety. As part of these corporate strategies, a process of investment in the acquisition and expansion of existing dairy sector companies is already under way in non-EU countries that are experiencing strong demand growth.

For some major EU dairy sector companies, the process is focused on finding outlets for the increased milk production that is projected to take place once EU milk production quotas are abolished in 2015. Overall, the EC's projections indicate that quota abolition will lead to an increase in annual EU milk production of some 9 billion litres, mainly in Denmark, France, the UK, Ireland, Netherlands and Germany.[1] Fully 67% of this expanded production (over 6 billion litres) will need to find markets outside the EU.[2]

The global dairy sector context can be seen as favourable to the pursuit of this strategy – milk production in emerging markets is growing more rapidly than in developed economies, but demand in emerging markets is increasing faster than supply.

Table 1: Dairy products: Outlook for demand and supply up to 2020

Region	Demand growth (%)	Supply growth (%)
Africa and Middle East	+4	+2
India	+10	+7
ASEAN	+4	+2–3
China	+7	+4
Europe	Less than 1	+1
North America	Less than 1	+1
Latin America	2	2
Australia and New Zealand	1	2

Source: Fonterra Australia, 'The global dairy industry', http://www.fonterra.com/au/en/Financial/Global+Dairy+Industry

China and other Asian markets are seen as providing some of the largest export opportunities for nations that produce a dairy surplus, but EU companies face competition on these markets from other global exporters that have far easier access to the markets and that produce at prices which largely set the benchmark for global trade in dairy products. While some EU companies are competing in these Asian markets, consolidating and developing the corporate position on African markets is seen as an important complementary policy.

EU dairy companies and global markets

Measured in turnover in US dollars, four EU companies are among the top ten global dairy companies. But with EU milk production quotas inhibiting growth in production, and in terms of milk intake, the New Zealand-based company Fonterra is far larger than any EU dairy company (with intake nearly half as much again, at 144%, compared to the largest EU producer). (See Table 2: Top 10 global dairy companies – 2013.)

In the longer term, EU companies have a greater interest in developing production and exports of high-value dairy products. In the short term, however, skimmed-milk powder (SMP) exports have been at the forefront of EU export growth, and this is likely to remain the case in the coming years. Between 2009 and 2012, EU SMP exports increased from 231,000 tonnes to 523,000 tonnes, before falling in 2013. (See Table 3: EU skimmed-milk powder: Exports 2009–2013.)

Table 2: Top 10 global dairy companies – 2013

Company	Country	Dairy turnover ($US billion)	Milk intake (million tonnes)
Nestlé	Switzerland	28.3	14.9
Danone	France	20.2	8.2
Lactalis (incl. Parmalat)	France/Italy	19.4	15.0
Fonterra	New Zealand	15.3	21.6
FrieslandCampina	Netherlands	14.9	10.1
Dairy Farmers of America	USA	14.8	17.1
Arla Foods	Denmark/Sweden	12.5	12.0
Saputo	Canada	8.8	6.3
Dean Foods	USA	8.6	12.0
Yili	China	7.6	4.0*

* estimated

Source: Canadian Dairy Information Centre, http://www.dairyinfo.gc.ca/pdf/list_glo20_e.pdf

Table 3: EU skimmed-milk powder: Exports 2009–2013 (thousand tonnes)

2009	2010	2011	2012	2013
231	376	536	523	403

Sources: figures for 2010–2013 drawn from EC/DG Agriculture and Rural Development, 'Prospects for agricultural markets and income in the EU 2013-2023', Table 6.27, December 2013: http://ec.europa.eu/agriculture/markets-and-prices/medium-term-outlook/2013/tables_en.pdf

Figures for 2009 drawn from the December 2012 report: http://ec.europa.eu/agriculture/publi/caprep/prospects2012/fullrep_en.pdf

Growth in EU exports of SMP is projected to resume in 2014, with steady growth through to 2023, when EU export volumes are projected to be 58% higher than in 2013 and fully 175% higher than in 2009, the year in which EU SMP exports really began to take off. These rates of growth are far higher than for EU cheese exports and even EU whey exports, while exports of butter and whole-milk powder are projected to decline.

Table 4: EU skimmed-milk powder: Projected exports 2014–2023 (thousand tonnes)

2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
454	576	607	619	622	623	624	634	635	637

Source: EC/DG Agriculture and Rural Development, 'Prospects for agricultural markets and income in the EU 2013-2023', Table 6.27, December 2013:

http://ec.europa.eu/agriculture/markets-and-prices/medium-term-outlook/2013/tables_en.pdf

The trade in SMP could potentially carry serious implications for the development of milk-to-dairy supply chains across Africa, given the increased technological scope for substituting milk powder for fresh milk in dairy products.

This provides the context in which EU dairy companies such as Arla, Danone and FrieslandCampina are taking a greater interest in investing in and exporting to sub-Saharan African countries.

African dairy sectors: Current situation and prospects

According to analysis from the OECD/FAO Agricultural Outlook 2012–2021,[3] consumer demand for dairy products is growing strongly in Africa. It increased by 22% in the 6 years to 2012, and considerable scope for further expansion is foreseen, as demand for dairy products is growing at twice the rate of the increase in supply. However, there is considerable variation between regions and countries in terms of the situation of African dairy sectors. In the immediate short term, the regions holding the greatest interest for EU dairy companies are West and Central Africa.

In major West African markets such as Nigeria, over half of demand is met through direct imports, while 75% of dairy products and dairy-related processed food products manufactured in Nigeria "rely almost entirely on imported powdered milk".[4] Similarly, Ghana has a near total dependence on bulk milk imports. The USDA sees Ghana as "a key access point for entry into the West African region market",[5] despite the fact that Nigeria re-exports 10 times as much milk powder (by volume) as Ghana.

Despite the heavy dependence on imports in major coastal countries, efforts continue to develop commercial dairy production across West and Central Africa, with the regional farmers' organisation ROPPA calling for increased tariff protection for milk products.

The majority of governments across the region are seeking to implement policies to promote local milk production in order to strengthen local food availability, create employment opportunities, reduce their trade deficits and promote structural development. Given that the majority of dairy farmers are smallholders, efforts are taking place in a number of countries (for example, Senegal) to invest in smallholder dairy supply chains in order to meet long-term objectives.

In East Africa, the East African Community (EAC) dairy sector is seen as having major potential for both demand and supply growth. Currently, regional production is around 15% lower than consumer demand, which is growing at around 3.5% per annum. In Kenya, dairy farming is reported to be "the fastest growing agricultural sub-sector".[6] This has led to the entry of private sector players and the formation of smallholder cooperatives, resulting in a significant increase in commercialised milk production (+150% between 2002 and 2011) and the development of increased value addition in the sector. Investments are also taking place in milk powder storage/processing facilities to iron out seasonal variations in liquid milk supplies.

The largest Kenyan dairy company, Brookside Dairies, is increasingly targeting regional markets, with operational braches in Uganda, Tanzania and South Sudan and an export trade which also includes Rwanda, Burundi, Indian Ocean islands, Egypt and the Middle East. Danone acquired a 40% stake in Brookside Dairies in July 2014.

The intra-African trade in dairy products is causing concerns in some countries, with the Tanzanian Dairy Board complaining of import levels that are now equivalent to national milk production, which has fallen dramatically over 15 years. While remaining Tanzanian dairy facilities are reportedly operating at only 27% of installed capacity, aspirations to develop local milk and dairy production remain.

In Southern Africa, the dairy sector is dominated by the South African industry, in which local and EU corporate players (Danone and Lactalis/Parmalat) are well entrenched. EU engagement since

1992 has either occurred in partnership with local dairies or through a process of acquisitions. More recently the South Africa dairy industry has been effectively integrating milk powder imports into its Africa-focused export strategy, with exports of value-added dairy products growing faster than imports of milk powders.

The expansion of South African exports has given rise to complaints of "dumping" from neighbouring milk producers, most notably in Namibia. This has led to calls for a more regulated trade regime for dairy products, despite the existence of a single market within the Southern African Customs Union (SACU). These concerns exemplify some of the difficulties faced in building regional markets, when producers in one country overshadow other regional producers. Such a situation often gives rise to considerable protectionist pressures on national food security grounds, and is further complicated by divergent dairy production standards.

This provides the regional context in which EU companies are seeking to engage with the African dairy industry.

Recent EU corporate initiatives towards Africa

- **The Arla Group**

The Danish-based European dairy company Arla estimates that after milk production quota abolition, "Arla's milk farmers will produce at least one billion kilos of milk more each year than today".[7] It is against this background of the pending expansion of milk production in northern European countries, where the Arla Group has its operations, that in October 2012 the Danish Confederation of Industries (DCI) convened a workshop on opportunities in the dairy sector in East Africa. According to DCI's website, "East Africa, in particular, offers favourable conditions for Danish companies since the dairy sector… has increasing consumption of milk and is in the process of modernising its market channels." Danish dairy sector related companies are seen as capable of offering "products, services and solutions to the East African growth markets" and of contributing to "developing the markets in a profitable way".[7]

In January 2013, Arla announced an increased focus on markets outside the EU, including in "Russia, China and the Middle East & Africa region". According to the Chair of the Arla Board of Directors, increasing sales of dairy products to new consumers in emerging markets "will help to maintain a viable dairy business in northern Europe".[7]

While the DCI seminar of October 2012 focused on dairy business opportunities in East Africa, it was in West Africa that Arla launched its first new initiative in Africa: in September 2013, Arla set up a joint venture in Côte d'Ivoire for the packaging and sale of milk powder produced in Denmark. Arla's joint venture partner, Mata Holdings, was already an established producer of single-portion soup sachets, and is to use the same sachets in repackaging the Danish milk powder. The operation is being established on a fully self-contained basis, involving a "new, mobile packaging station" which operates from "three 40-foot containers", using solar cells to deliver a 12-hour production cycle under temperature-controlled conditions. The facility has the capacity to process 2,000 tonnes of milk powder annually, can deliver 8 million litres of milk to market and is seen as a low-cost means of exploiting mass-market demand for milk in Africa.[8]

- **FrieslandCampina**

FrieslandCampina has an established presence in the main West African market of Nigeria through its subsidiary FrieslandCampina WAMCO (FCW). FCW supplies the leading milk brand in Nigeria (Peak), using raw materials imported from the Netherlands to produce end products such as evaporated milk and convenient packages of milk powder. The CEO of FCW has expressed the view that if an appropriate policy framework were established, "Nigeria could become one of the world leaders in the production of dairy products in a few years".[9] However, he acknowledged that this would require a form of public–private partnership, with the Ministry of Agriculture focusing on developing milk production and the private sector focusing on connecting farmers to markets.

According to FCW, it has been exploring the scope in Nigeria for increasing local milk sourcing in association with local companies since 2008. In August 2010, a local milk collection operation was established, and in 2011, FCW concluded a memorandum of understanding with the Federal Ministry of Agriculture on the rolling out of an initial network of milk collection centres. The company has set a short-term target of 10% for local procurement, within a vision of 50% local milk procurement within 10 years, on the basis of smallholder production systems.[9]

However, FCW acknowledged in 2012 that it was cheaper to import raw materials than to purchase raw milk locally (with landed costs between N70 to 80 a litre, compared to local procurement costs of N90 per litre – 100 Naira is currently worth €0.46). In this context, the realisation of corporate plans to expand local milk sourcing is likely to be strongly influenced by trends in the use of imported raw materials by FCW's competitors.[9]

- **Danone**

In October 2013, Danone announced that it had joined with the Abraaj Group to acquire Fan Milk International (FMI), within a framework whereby Danone would gradually take over a controlling interest. FMI is a dairy and fruit juice distribution company with its main operations in Nigeria and Ghana (80% of sales) but with distribution networks across a total of six West African countries (Ghana, Nigeria, Togo, Burkina Faso, Benin and Côte d'Ivoire). FMI, which had its roots in Denmark, "relies on a fleet of more than 30,000 street vendors, operating push carts and bicycles, to distribute its growing portfolio of fruit juices and [frozen] dairy products". It uses imported milk powders to produce a growing range of reconstituted dairy products.[10]

Through the takeover of FMI, Danone "hopes to develop the dairy product market in West Africa, using Fan Milk's unique business model". Danone's Chief Operating Officer Emmanuel Faber maintains that "this transaction represents a major step in Danone's expansion in Africa". According to analysts, "Africa is becoming a major expansion axis for Danone and [tomorrow it will be] an important growth booster."[11]

In January 2014, unconfirmed reports emerged of Danone's planned acquisition of the shares in East Africa's leading dairy company Brookside Dairies, held by the Abraaj Group, Danone's partner in the FMI acquisition. Brookside Dairies has itself been involved in acquiring local dairy companies and has been investing in local milk powder production. In July 2014, it was confirmed that Danone had acquired a 40% stake in Brookside Dairies. The partnership with Danone, by improving access to dairy sector technologies, is expected to further enhance Brookside's competitive position.

Two distinct issues potentially arise from this. The first is the issue of the impact of investment from Danone on competition across the East African dairy sector, given Brookside's already dominant position in the industry. Second, how will Danone's interest in opening up markets for milk powder exports be reconciled with the development of local milk powder facilities, aimed at ironing out local seasonal supply fluctuations?

In South Africa, Danone had a good reputation for introducing new dairy products to the market in response to evolving consumption patterns, in ways which both expanded demand for locally produced milk and also supported milk prices. However, in West Africa, Danone's recent acquisition (Fan Milk International) depends exclusively on imported raw materials, producing a range of dairy products which are then distributed across West Africa. It is unclear which route

Danone would choose to follow in meeting rising consumer demand for dairy products in East Africa.

Policy issues arising for African governments

A number of African governments have aspirations to develop both local milk production and value-added dairy processing. However, recent patterns of EU corporate investment raise the question of how this is likely to impact on the development of supply relationships between local milk producers and local dairy processors.

Given these aspirations for African dairy sector development, it would appear important that EU companies go beyond simply importing finished products and milk powder for processing in meeting expanding demand for dairy products. For example, European dairy companies could be encouraged to engage in developing local milk supply chains by enhancing local technical capacities to collect, store and process milk into value-added dairy products.

Representatives of the DCI have sought to highlight how Danish companies have the experience in processing to play an important role in supporting the development of dairy value chains in Africa. The view has even been expressed that "a sustainable competitive position cannot be held by exporting bulk commodities from Europe to sub-Saharan Africa" and that "a true competitive advantage will only be attained from investing directly in the market and thus building up a value chain that will allow dairy companies to supply the consumers of sub-Saharan Africa with home-grown products."[11]

This can be seen as a positive opportunity arising from growing EU corporate interest in African dairy sectors. Yet, as the Arla analysis makes clear and current patterns of investment by both Danone and Arla confirm, the short-term pressures to find outlets for expanded milk production are intense. Bulk commodity exports meet growing demand in Africa and ease pressure on domestic EU markets in a context of limited demand growth in the EU and intense competition on the Chinese market from other major competitive global players. The deployment of turnkey technologies such as the Arla joint venture in Côte d'Ivoire and investment in established companies (e.g. Danone's acquisition of FMI) are relatively low-risk, high-return strategies, in comparison to FCW's efforts in Nigeria that focus on developing local milk supply chains.

Against this background, the question arises:

- What policy options do African governments have for promoting patterns of EU investment that sustainably develop milk supply chains and value-added processing?

Clearly, government support in getting to grips with production and infrastructure constraints along dairy supply chains is a critical area for intervention. Policy initiatives to encourage private sector investment in strengthening the physical infrastructure and logistical capacity for milk collection would also help. These are likely to require an intensification of dialogue with stakeholders and close coordination of government and private sector initiatives.

A nuanced policy on the licensing of duty-free imports of milk powder could also play a role. The way that the EU trades in SMP is critical in determining whether the trade supports or disrupts the development of local milk-to-dairy supply chains.

Experience in South Africa in the 1990s suggests that in the face of 'surplus' stocks of milk powder in the EU, two distinct patterns of EU investment can take place:

- joint ventures can be established that focus on developing markets for new value-added dairy products and on strengthening local milk supply chains; or

- acquisitions of local dairies may take place simply to access local distribution channels and integrate the local dairy processing sector into global sourcing chains for dairy ingredients.

By altering the patterns of use of fresh milk in dairy products, different patterns of investment can have very different effects on local milk production and dairy farming.

The earlier South African experience highlights the need for careful consideration to be given to the effective regulation of trade in milk powders and other dairy sector ingredients within any government efforts to promote local dairy sector development.

Experience in other sectors suggests that, if transparently managed, linking import licence allocation to compliance with realistic targets for local milk sourcing could assist in strengthening the functioning of local dairy supply chains. In addition, linking import duty rebates on milk powder imports to the introduction of incentive prices for local milk producers could induce investment in expanded commercial milk deliveries, in order to reach the critical mass for the operation of commercially viable milk collection systems.

More recently, an important regional policy dimension has emerged, as South African dairy companies integrate increased milk powder imports into their regional strategies for expanded dairy product exports. Milk power trade policy is thus a regional as well as a national dairy sector issue, with important competition and rules of origin issues emerging under regional trade agreements.

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