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Olive Oil - Make it for Market¹

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1. Introduction

¹ Views expressed in this paper are those of the authors and are not necessarily an expression of policy of Primary Industries and Resources SA.

The paper is an edited version of a paper presented to the Australian Olive Association Annual Conference in October 1998 at Kingaroy, Queensland.

This paper provides a brisk exposure to some of the facts associated with marketing of olive products but it should not be mistaken for a 'wet blanket'.

Interest in olive growing and processing by farmers and small and large investors is very high. The reasons for this interest include investing in agribusiness, achieving farm diversification or participating in a lifestyle movement (Burr 1998).

While planting proceeds apace, olives continue to spread as wandering weeds (McKinnon 1998, Stephenson 1998). The escape of olives is a topic worthy of consideration in it's own right and deserves closer examination. In particular negative externalities associated with the escape of olive plants require analysis.

A demonstration of the marketing challenge facing the industry was given in a paper presented to the Australian Olive Association in February 1997 (Davies 1997). The paper illustrated the potential for forty percent of domestic consumption to be met by local production within ten years. The basics of marketing (market segmentation, positioning and the marketing mix) were discussed at an industry meeting later in that year. The marketing theme has been taken up over the past year and there is now a lot more interest in the subject which is to be expected as basic agronomic problems are overcome and groves come into production.

This paper examines supply and demand for major market segments (virgin and pure olive oil) and it suggests that marketing issues be tackled on an industry rather than an individual basis because, as production increases, there are new challenges that are better dealt with on a collective basis.

2 The \$110 Million Catchcry

Phrases like "there is an import replacement opportunity for olives of \$100 million per year" are common. This is based on Australian imports of about 17,000 tonnes of olive oil each year with a value of about \$90 million and about \$20 million of table olives. Whilst being factually correct, it is important to spell out some implications for Australian producers.

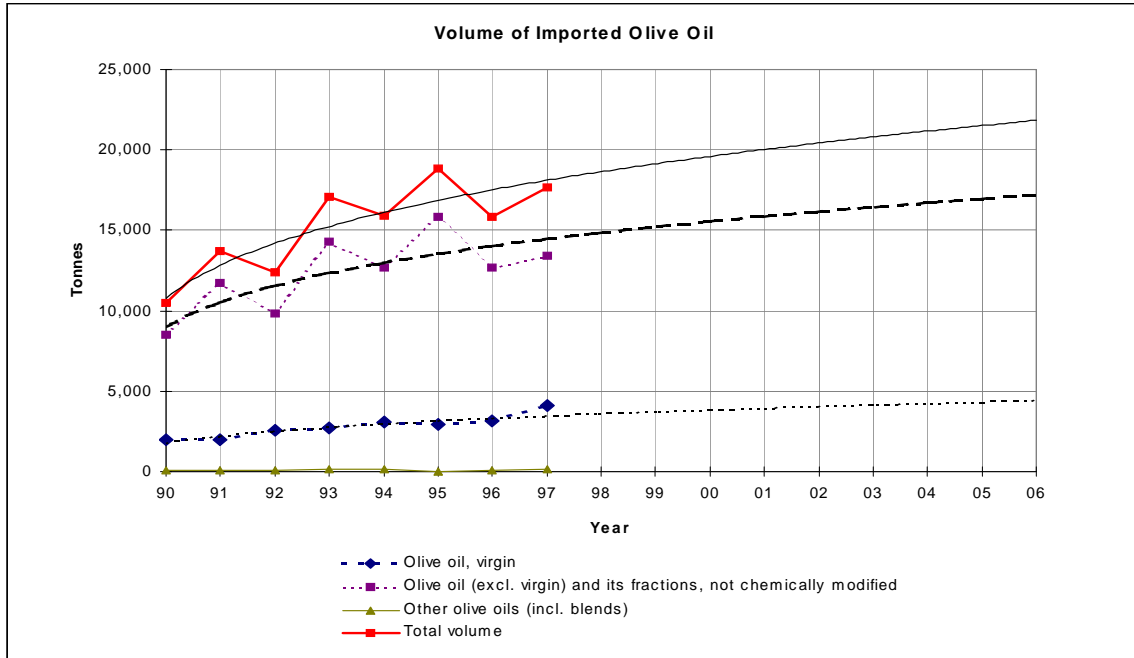
There has been an average annual (compound) growth rate of olive oil imports of around 15% over the past ten years - 6,840 tonnes in 1988 to a high of 18,847 tonnes in 1995. The value of oil imports in 1997 was close to \$87 million and table olives around \$24 million. Volumes of imports fluctuate from year to year. Recently this has been in part due to shortage of supply and increased prices following drought in Europe and the changes in the exchange rates. However, overall it seems reasonable to assume that the growth rate of demand will start to level off.

The statistical trend line indicates a slowing of total olive oil imports to give around 22,000 tonnes in the year 2006, of which about 4,500 tonnes will be virgin olive oil (Figure 1). This is an important distinction to make in the light of the often quoted "\$100 million import replacement opportunity" ie about 80% of demand is in the lower quality oil, and while the higher quality virgin oils attract a price premium, it represents only 20% of the market by volume.

It is this smaller premium market which the majority of growers seem intent on targeting. So the \$110 million import replacement market is reduced to around \$22 million for virgin

olive oil in 1996/ 97 terms. What will the situation be when local production comes 'on-line'?

Figure 1. Projected Volume of Australian Olive Oil Imports



3 Supply and Demand Estimates for Olive Oil

Assuming local production accounts for 5% or less of consumption and very small volumes are re-exported, imports are roughly equivalent to consumption ie 22,000t in total.

One and a half million trees (representing about 6000 hectares) are estimated to be in production in Australia by the year 2006. Assuming 90% of fruit is used for oil, an average yield of 35kg/ tree and an average 15% oil content, this represents about 7,000 tonnes of oil, of which let us say 60 percent, or 4000t, is virgin quality. Production and consumption balance is then as indicated in Table 1.

Table 1. Australian Olive Oil Production and Consumption Balance (tonnes)

	Total Oil	Virgin Oil	Pure Oil
Current consumption (96/97)	17,500	4,000	13,500
Projected consumption (2006)	22,000	4,500	17,500
Volume increase in demand	4,500	500	4,000
Projected local production (2006)	7,000	4,000	3,000
Supply surplus (deficit)	2,500	4,000	(1,000)
Projected market share (2006)	32%	94%	16%

It can be seen from Table 1 that in total there would be an overall excess of production of 2,500 tonnes of oil by 2006 (assuming that there is no growth in imports; a very unlikely scenario). To successfully 'quit' the projected Australian crop in the domestic market would mean replacing this amount (2,500 t) of imported product ie capturing 32% of the local market overall. However, the picture is substantially different if one segments the

market. Local virgin oil would be required to gain 94% of the market, displacing 4,000 tonnes of imported oil. In contrast the pure oil sector would have a shortfall of 1000 tonnes with Australian oil making up only 16% of this sector.

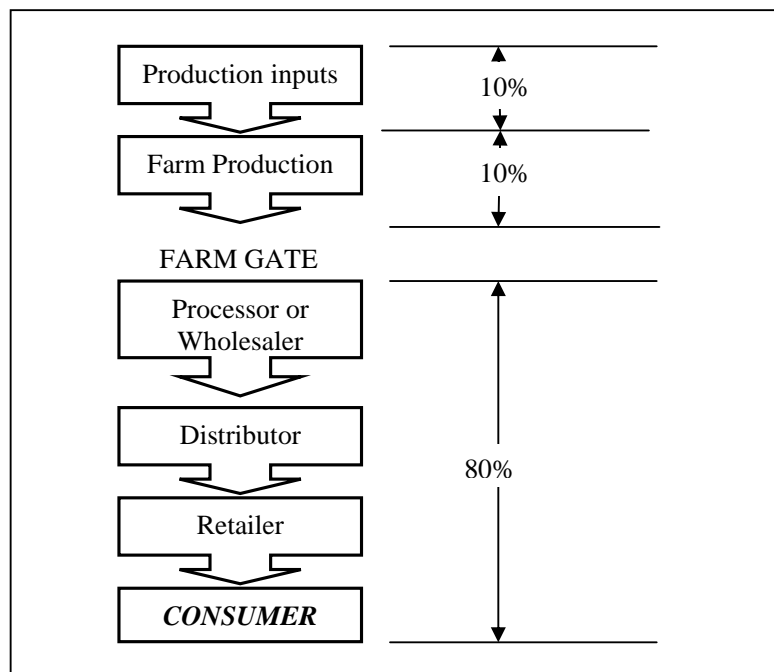
Using different assumptions you will get different final figures (McEvoy, D; Gomez, E. 1999). However the underlying messages are clear. The Australian olive oil industry has the opportunity to choose one or more of the following future directions:

- expand the total domestic market above projected levels and/ or
- capture domestic market share from current importers
- enter and increase selected export markets
- capture export market share from current competitors

4 The Marketing Chain

Industry and individuals need to take responsibility for their products. The lesson of other agricultural commodities is that the producer often gets what is left over after the rest of the market chain take their cut, unless you get actively involved in the marketing. Up to 80% of the retail value of a product is captured in the post farm gate portion of the market chain. It is important therefore to consider at the outset how far down the market chain you want to or need to operate in order to be profitable (Figure 2).

Figure 2. Proportion of Revenue in Marketing Chain



A model of the olive oil market chain (Table 2) shows that it is possible for Australian growers to put olive oil on supermarket shelves at a price comparable to the majority of current imports. However, as the bulk oil price rises above \$4/L at the farm gate, the price of Australian oil in the supermarket exceeds the price of most Spanish and Italian imports on supermarket shelves.

Table 2. Market Chain Analysis

Stage	Return/L →			
	Import Parity			Premium Niche
Grower growing and processing to bulk oil	3.00	4.00	5.00	6.00
Wholesaler bottling cost	2.42	2.42	2.42	2.42
Grower price and bottling cost times 30%	1.63	1.93	2.23	2.53
Retailer wholesale +50%	<u>3.52</u>	<u>4.18</u>	<u>4.82</u>	<u>5.48</u>
Total Retail Price	10.57	12.53	14.47	16.43

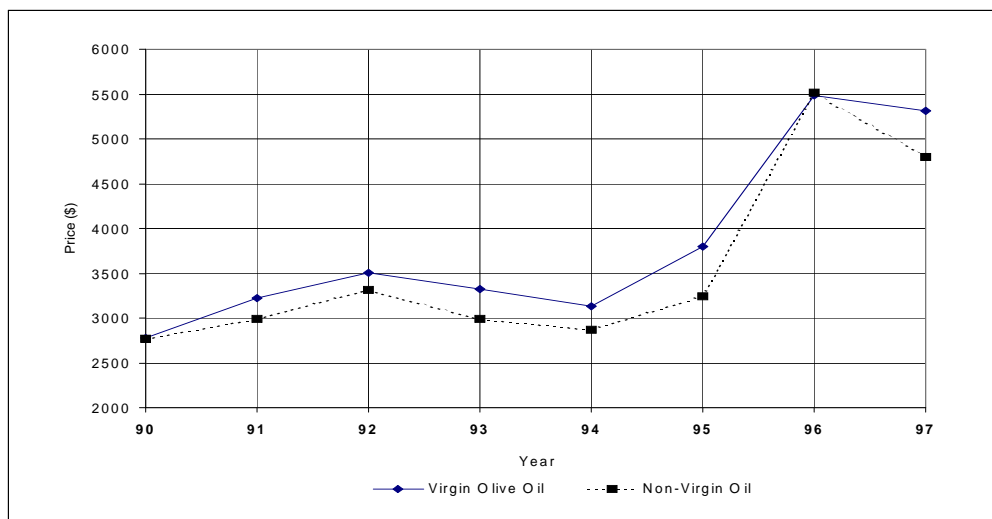
It is often argued that there is a substantial premium to be gained by producing extra virgin olive oil and this is where the industry should be heading. Unfortunately this is not borne out by the import figures (volume of imports divided by price) from the Australian Bureau of Statistics (Figure 3). It is acknowledged that this is a crude average and that the highest grade imported oils are expensive, but it indicates that the consumer does not appear to recognise the value which industry 'insiders' ascribe to virgin oils.

It is possible that consumers may pay a slight premium for an Australian product and thereby allow farm gate prices to move towards \$5/L but the clear messages from this analysis are:

- Ensure that production is efficient to keep costs down (higher margins)
- Promote the use of olive products (increase demand)
- Move consumer preferences towards quality (higher prices)

Pursuing these strategies on an industry-wide basis will help to ensure long term profitability.

Figure 3. Average Price (\$/t) of Imported Olive Oil



5 Marketing versus Selling

A marketing, as opposed to a selling, approach is the best way to achieve industry goals of increased market share, expansion of the market and import replacement. Growing and processing to a long term contract is a secure way of ensuring that what is made can be sold. This is in contrast to trying to sell what is already grown and processed.

The first step is to determine which are the most attractive markets and to segment them in order to be able to effectively target one or more (Figure 4).

The second step is to position the product clearly within the target market (Figure 5).

The third step is to establish a marketing plan based on a suitable 'marketing mix'.

These steps cover the four p's of marketing viz price, product, place and promotion to establish a sustainable competitive advantage. The following sections examine these key issues related to the marketing of olive products from the perspective of the industry as a whole.

Figure 4. Market Segmentation

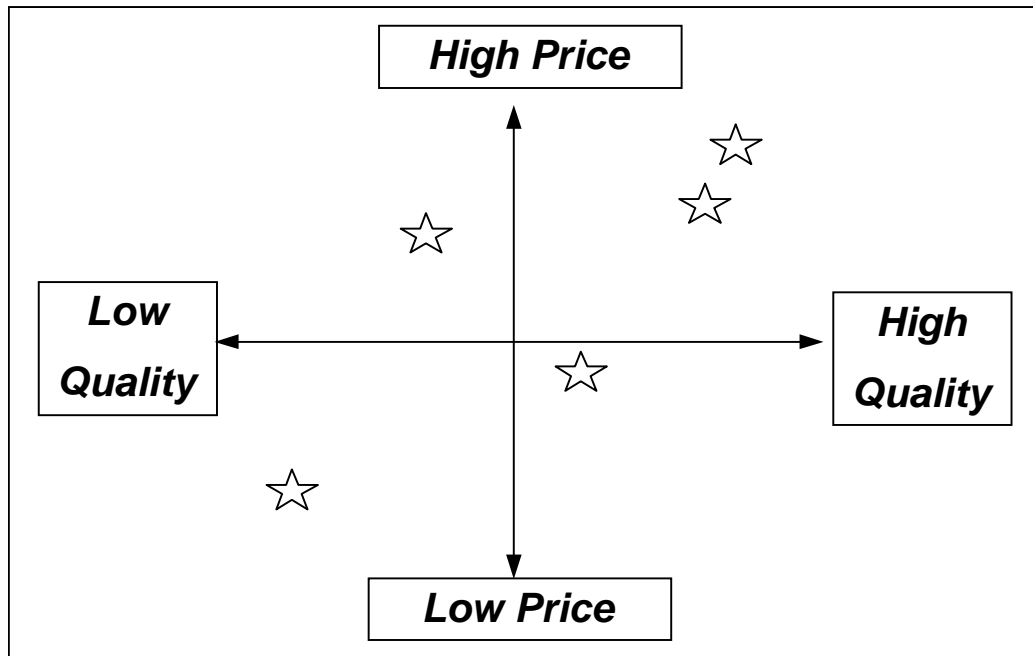


Figure 5 Product Positioning

		Product		
		<i>Extra Virgin</i>	<i>Virgin</i>	<i>Pure</i>
Market Sector	<i>Retail</i>			
	<i>Food Services</i>			
	<i>Manufacturing</i>			

Price

The growth in interest in olive oil production is driven to some extent by high prices (\$22 to \$65/ litre) which are currently being achieved by some locally produced oils. A number of the current market leaders in the boutique olive oil segment have either existing networks through the wine industry and retail sector or have invested in developing the 'downstream' aspects of their business, allowing them to capture the additional value. However, as pointed out in the discussion above, this is a limited market.

In contrast the 'floor price' or 'import parity price' is set by lower quality imported oils, mainly from Spain, which are retailing at \$8 to \$12/ litre in supermarkets. This implies that the import price is around \$4/ litre or less. What does this mean for the viability of the industry in general?

Models of olive production show that adequate returns on investment (10% - 15%) are achievable with mechanised, irrigated groves. This is based on 100ha yielding 12 tonnes per hectare with oil extraction of twenty percent (Hobman 1995). With these assumptions the grower's cost of production appears to be about \$3 per litre (Cook 1998).

Product

The demand for volume implies either an extensive trading network whereby brokers/merchants consolidate lines of product or by grower-based marketing groups, organised to gain market leverage and capture the value added dollar. Clearly from a grower's perspective the latter is preferable bearing in mind the comments above about the traditional position of growers as price takers. Unless the smaller growers in particular are members of a marketing group they will be unable to benefit from improved marketing and any revenue increases will accrue to the non-producers in the chain (Figure 2 and Table 2).

Supermarket demand for consistency and food safety will necessitate the use of either proprietary or generic quality assurance systems and testing which will extend back to the olive grove in the form of documentation to allow third party auditing. It is happening in other fruit industries. An industry organisation response is required to ensure effective programs are developed and made available to industry participants.

Place

With the Australian industry projected to produce 7,000 – 10,000 tonnes of oil per year in the near future, the major outlets for the majority of this produce will be supermarkets or the food services sector. Both of these sectors want volume, consistency and safety from all their products. Collaborative arrangements and an industry-wide approach can best accomplish this. The major supermarket chains in particular are working hard at eliminating the risk of poor quality and contamination in their products through the use of product specifications and quality assurance processes.

There is a trend towards consolidation and globalisation in supermarket chains around the world and they have annual turnovers of over \$50 billion each year with an expectation that they will have full product lines all year round. They have great market

power the local olive industry needs to meet the requirements of this market sector. Of course, supermarkets are driven by their customers in a competitive environment.

Promotion

In a global, competitive environment the Australian olive industry participants need access to mass outlets.

One leading supermarket spent \$35 million last year on advertising to 'defend' two of its pet food brands. A wide range of products compete for supermarket shelf space and individual growers do not have this sort of promotional resources.

Competition against other vegetable oils will be intense and response to changes to the way people regard food will determine olive industry fortunes. For example, increased workforce participation, decreased household size, and reduced home cooking will all influence buying patterns.

Australia does have an opportunity to promote its ability to produce high quality, pure and healthy olive products due to its environment and level of training and education in horticultural industries. There is a role for the Australian Olive Association to be involved in promotional activities funded by the industry as a whole.

6 Conclusion

Supply projections for Australian olive oil products indicate significant volumes of oil, including virgin oil, will be entering the existing domestic market by 2006. Local production will be competing with imports, particularly in the virgin olive oil market. The extent of competition and market shares will depend on future demand, and domestic consumption per head in particular.

It is important that the local industry collaborates in marketing and does not approach it only from the individual business viewpoint. There are warnings and examples from other industries about how to market primary product.

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