CAS Paper 37

Future global, EU and UK markets for milk and milk products – *implications for the UK dairy industry*

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5 The nature of demand and the location of emerging and exploitable markets - international markets

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INTRODUCTION

This paper considers the definition and nature of demand, and their importance in the context of locating emerging and exploitable markets. It further considers the question of why the location of those emerging and exploitable markets is, or should be, of interest to those who have a very strong domestic industry. In order to explore this a little more fully it is necessary first to discuss the concept of demand. According to Websters Dictionary, demand is the desire to purchase a commodity accompanied by a means of payment. Given this definition, and looking at the UK domestic market, and looking at the domestic market in the United States (US) and in Europe which are very strong, it is clear that there is demand and the ability to pay. However, the question is whether that demand is continuing to grow, and this is the issue that this paper addresses.

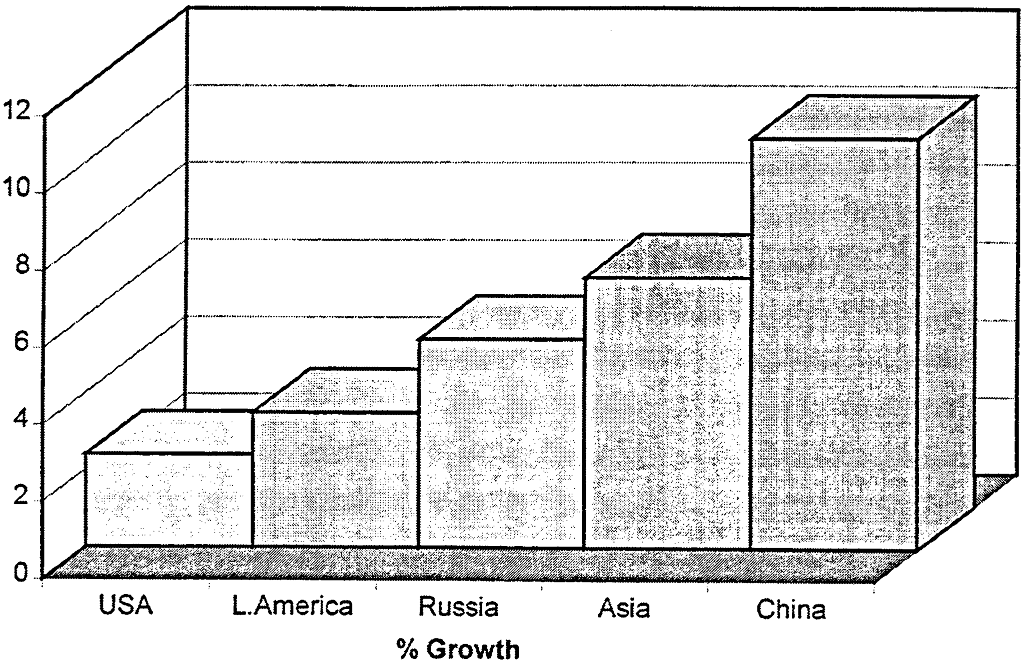
The markets mentioned above are 'mature' markets as far as many dairy products are concerned. In a mature market, in order to keep market share from dropping, a company has to do one of two things: either develop new products and/or develop new markets. There are many new dairy products being developed both in the food and the non-food categories. In the United Kingdom (UK), the European Union (EU), the US and in the rest of the world it is necessary to develop new markets for those new products that are being developed and also for the products that already exist.

WHAT DRIVES DAIRY DEMAND?

Rising per capita income

There are many things that drive demand and a number of them will be highlighted here. First of all there is a direct correlation between a rise in per capita income and the increased consumption of animal protein. If one considers the criterion of rise in per capita income and looks at the relative economic growth in various parts of the world (see Figure 1) it appears that with just over 2% growth the US has a very strong economy. However, in Latin America growth is at almost 4%, in Russia almost 6%, Asia about 7%, and China 10%, and it is very significant that the growth is in the emerging markets not in the mature market of the US.

Figure 1
Relative Economic Growth



Growth in fast-food restaurants

With growth in fast-food restaurants, for example, as 500 new pizzerias opened in Korea, a 5-t/year mozzarella market in 1990 grew to a 10 000t four years later. If one considers how fast-food drives a dairy diet (cheeseburgers, pizzas, milkshakes, etc) looking at the growth of fast-food in the US in 1996 (see Figure 2) it is clear that there has been growth, the top 100 having about 5% growth, Dairyqueen and McDonald's had surprisingly, one of the lowest domestic growths and Starbucks (a coffee company) had about 40% growth. All these fast-food outlets use a lot of dairy products. If US growth is compared with that in the overseas market, again in 1996, (see Figure 3), it can be seen that growth is in the overseas markets, not in the US market, with growth anywhere from 10% to >70%, (75% for Starbucks).

Government programmes

When governments support an industry, that industry will usually grow. In Algeria when milk was designated as a principal source of animal protein, consumption grew. As a result of school lunch programmes in Asia, and in Japan in particular, and subsidised consumer programmes in Mexico for example, demand has increased, the diet has become 'westernised' in terms of its dairy component and sales in the dairy sector have increased.

Figure 2
Growth of Fast Food Outlets, US, 1996

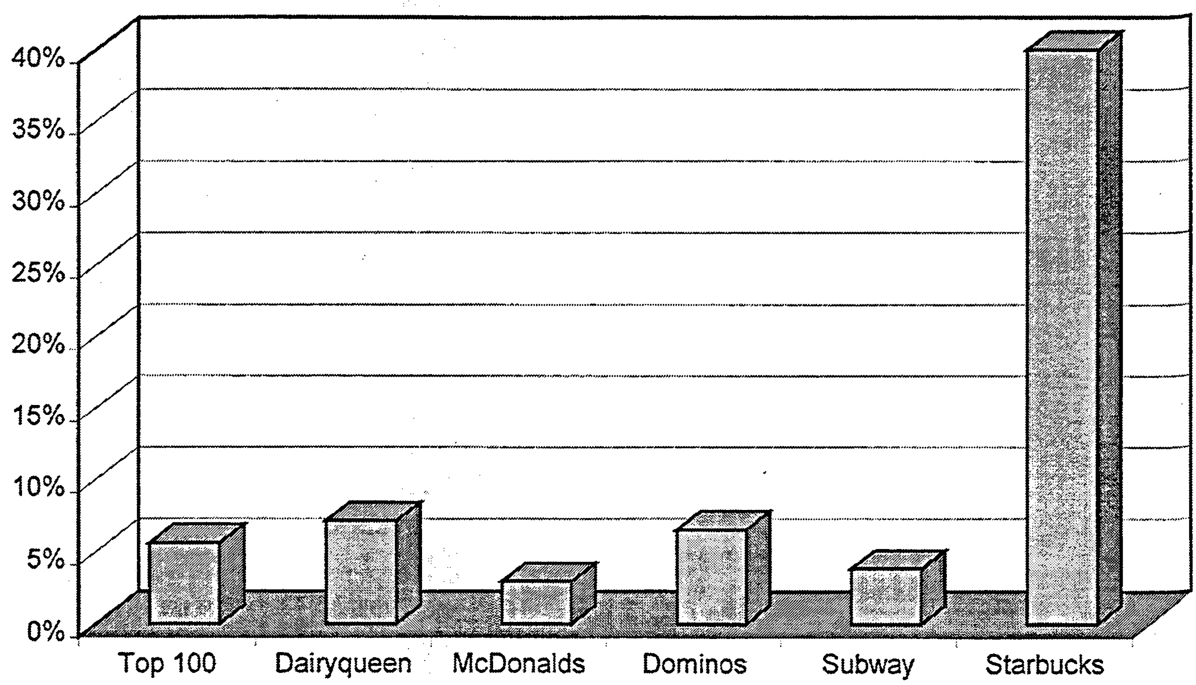
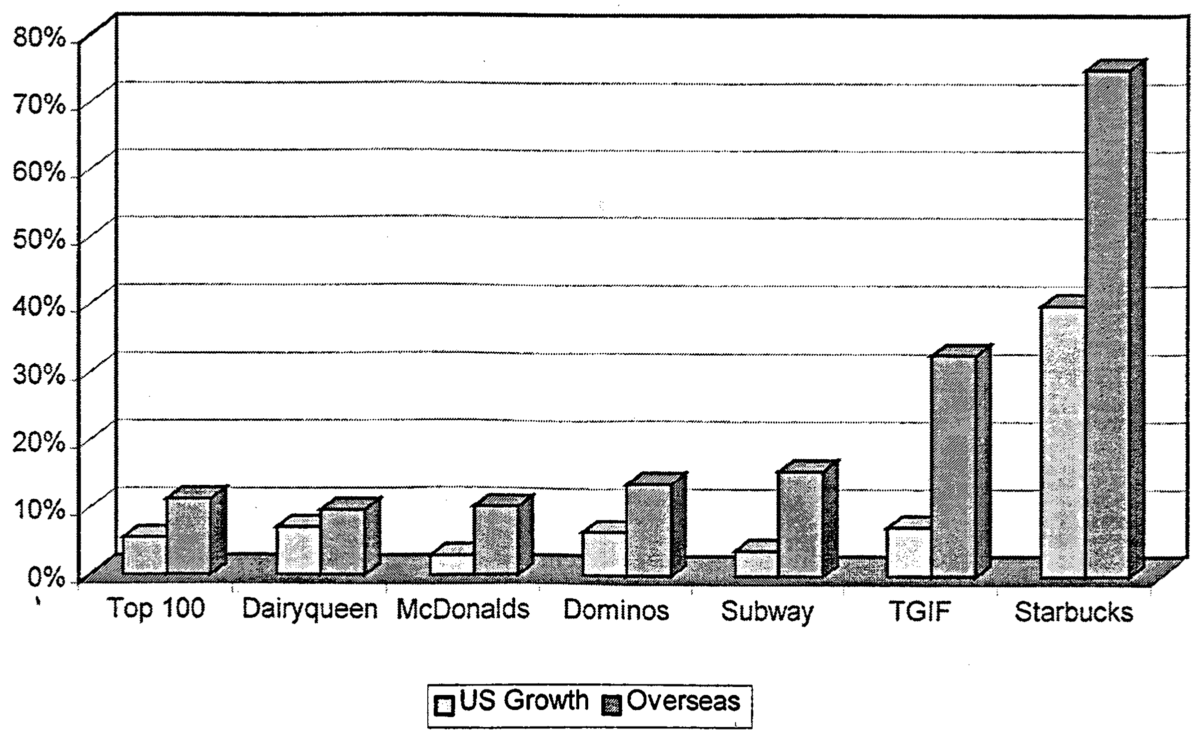


Figure 3
Growth of Fast Food Outlets, US and Overseas, 1996



Tariffs and trade barriers

This is a very important issue particularly as following the Uruguay Round completed in 1995, there are lower export subsidies, lower import tariffs and a growing international market place. Economic growth in general depends on an accumulation of capital and labour and the productivity of that capital and labour. There are two paths to growth in the productivity of capital and labour. These are internal innovations either domestically achieved or imported. In emerging markets in particular it is very difficult to find sufficient adequately trained and creative individuals to create that innovation internally. So in emerging markets it is generally necessary to import that technology, that innovation, and one way to do that is by importing the product, and having it developed internally. This will create economic growth. However, tariffs and trade barriers constrain a country's potential for economic growth. As was pointed out above, economic growth drives dairy demand. Free trade grows markets; lower tariffs maximise market access. It is necessary to ensure that rules are enforced, and that support is given to programmes that maximise competitiveness because this is going to grow dairy demand in all the markets.

The availability of substitute products

This does not necessarily mean substituting European products for US or New Zealand products. It means substituting liquid milk for cola or orange juice or iced tea. It means substituting whey powder for skimmed milk powder in animal feed. It means substituting margarine for butter. In times of an economic crisis, that becomes much more of an issue because customers will generally do one of three things before they actually start purchasing or eating a product. They will either eat the products less frequently, they will purchase smaller unit sizes of the product, or they will substitute fulfilled or non-dairy products.

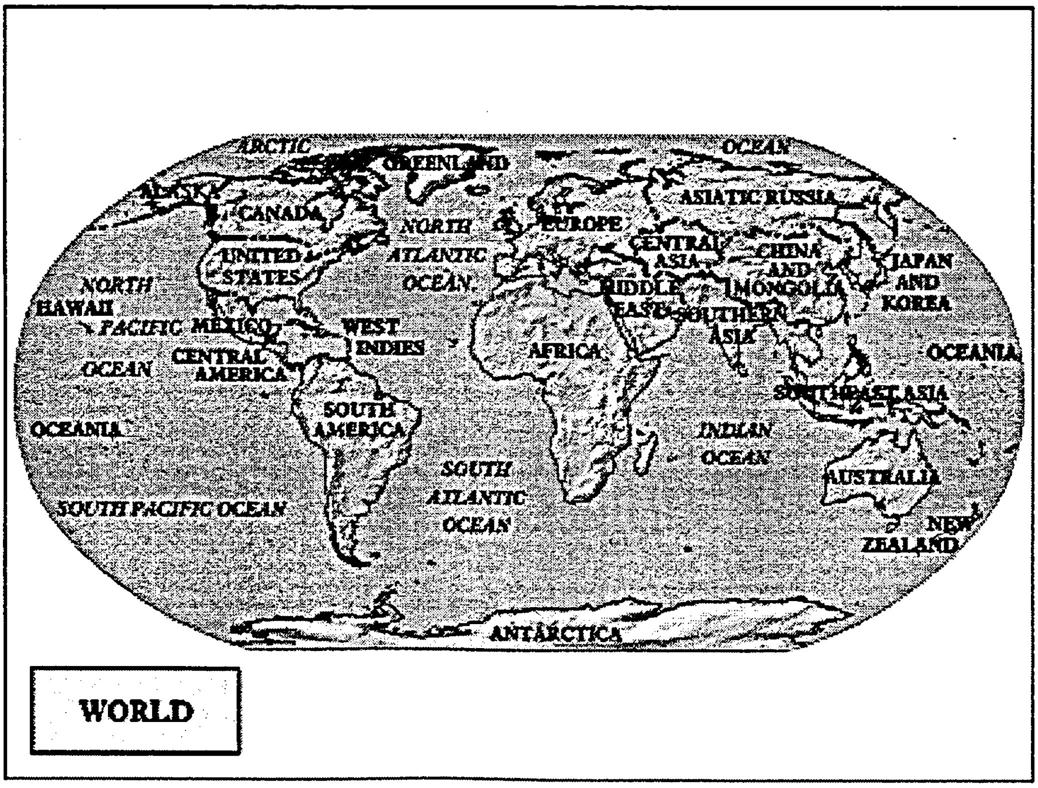
EMERGING AND EXPLOITABLE MARKETS

Having looked at some of the factors that drive dairy demand, their relevance in identifying emerging and exploitable markets can be examined. These markets have some common characteristics:

- growing demand
- production efficiency
- generally open access

Figure 4 shows Latin America, Japan and Asia as having these three drivers of emerging and exploitable markets. The Latin American and Asian markets are very different, but have similarities such as a rapidly rising income, westernising diet, and increasing market access. However, currency shocks and retarded economic growth are affecting the ability of these regions to import. This happened in Mexico in 1995, could potentially happen in Brazil at any time, and is currently happening in Asia. If one considers this in more detail, China, Hong Kong, Thailand and The Philippines were not hit as hard as other parts of South-east Asia, and will probably recover within one to two years. They will continue to purchase dairy products in the meantime. Again, they will probably purchase smaller unit sizes, they may not have the same level of stocks as before, and they may purchase less but they will continue to purchase. Looking at Korea, Malaysia and Indonesia, which are much harder hit by the current financial crisis, their recovery is going to take longer, probably three to five years, and they will substitute or stop buying some dairy products in the short term. In general, when one looks at emerging markets, and considers market development, the concern is not the next six months, the next year or the next two years, but a much longer term. In the short term it is going to be affected; in the long term it will be hardly a blip. High value dairy products will be especially hard hit. US exports of premium ice cream went completely flat in that region of the world and exports to Korea of mozzarella cheese for the pizza industry also fell.

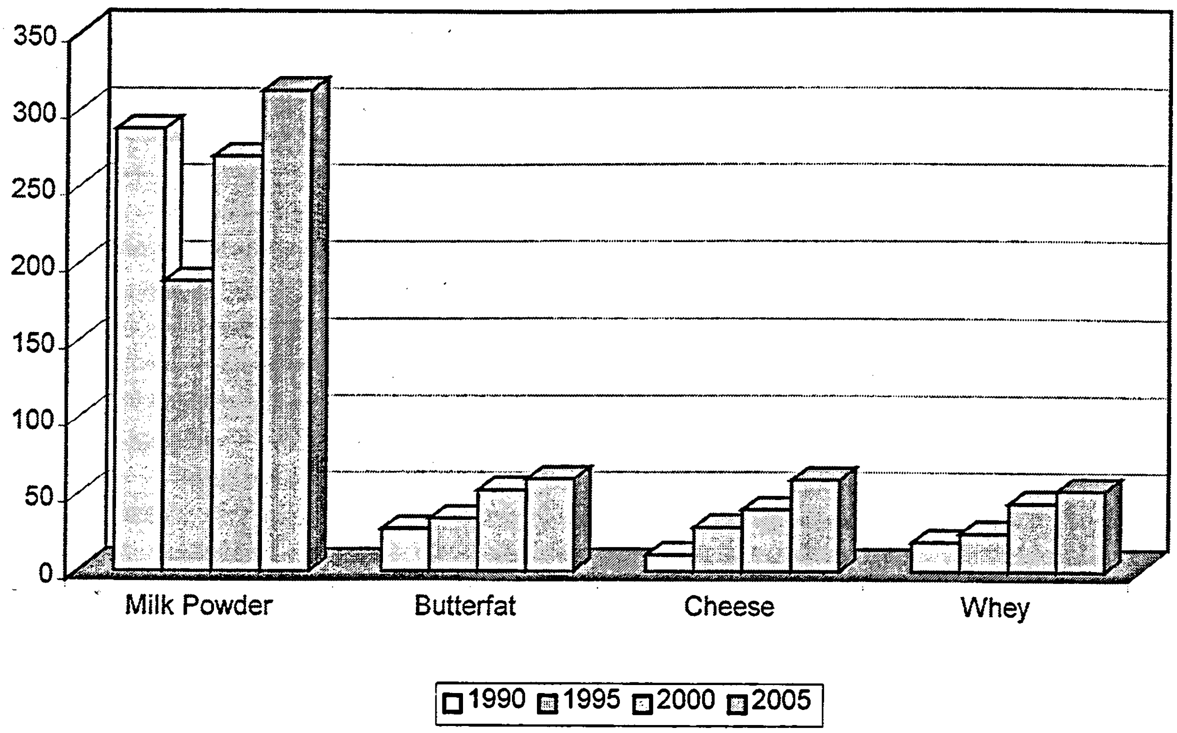
Figure 4
Emerging and Exploitable Markets



Mexico

In Mexico, there is a rise in per capita income, the population is culturally accustomed to dairy products and has a westernised diet and there are beneficial tariff rates, certainly for the US but also with other countries. Figure 5 shows the market growing from 1990 to 1995 to 2000 to 2005. With the exception of the 1990 market for milk powder and then the drop in 1995 (which was incidentally not a result of the 1995 economic crisis, but because too much was bought the year before) there is a steady growth in all products. There is a small significant growth in cheese which is a high value product and can offer higher returns from market development than more basic dairy commodities the demand for which is simply price sensitive.

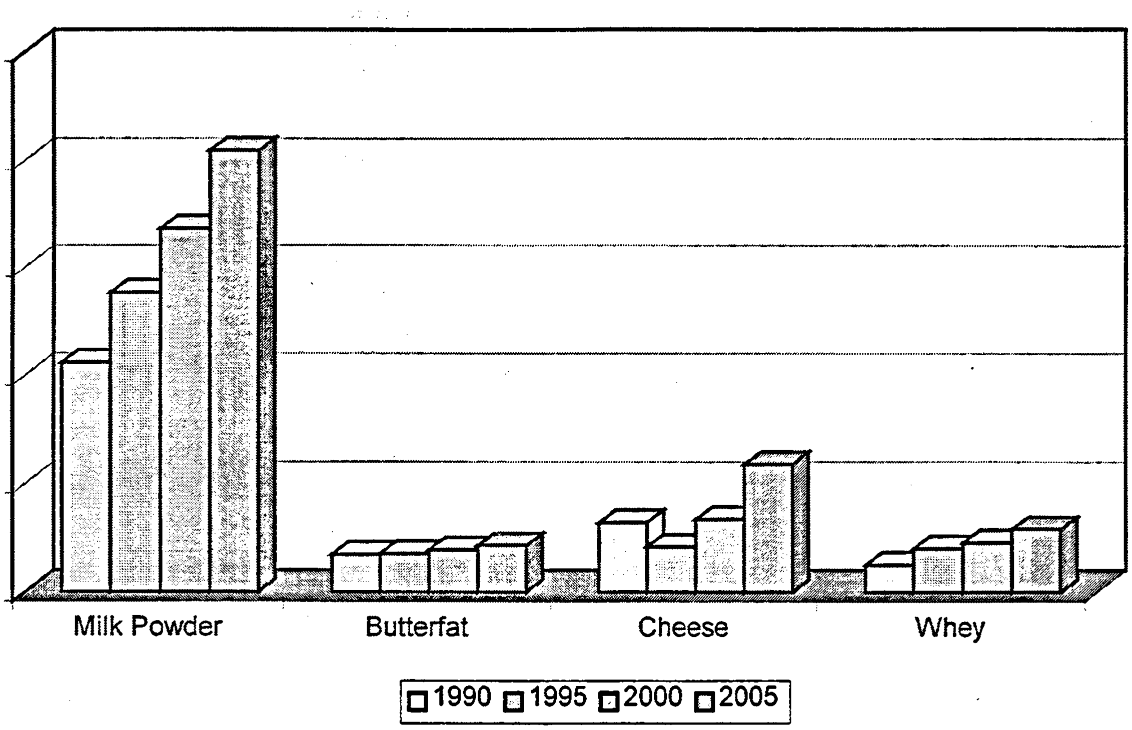
Figure 5
Mexico Dairy Product Consumption



Latin America

Turning to the rest of Latin America, again there are growing economies, rising per capita incomes and cultures accustomed to dairy products. But, there are unstable economies, such as Brazil. Brazil also has the problem of 'dancing' tariffs. The government can raise these overnight, and has on many occasions raised them significantly. Product in transit sold at one tariff rate on departure can face a significantly higher tariff rate on arrival at port, making it a little harder to make any kind of a profit. There is also local competition. The South America countries, Argentina and Uruguay, are big producers; Brazil is also a big producer, but not self-sufficient. There is growth here, (see Figure 6), not so much in butterfat, but the cheese market is growing significantly, the whey market is significant, and so is that for milk powder.

Figure 6
Latin America Dairy Product Consumption



Japan
On the other side of the globe, Japan has high per capita incomes, very similar to those in the US. Japanese consumers have a growing usage of dairy products and they have an awareness of the need for dairy products in their diet for health reasons. Japan was not so affected by the current financial crisis. Japan is having its own crisis, but it is not the same as the one in South-East Asia and Japan has a very strong economic base. Growth here is very significant, particularly for cheese. Milk powder will go down but whey is going to grow though not quite as significantly as the cheese market. A key feature of the market for dairy products in Japan and the rest of Asia is that it is very heavily dominated by Australia and New Zealand. In fact the EU has lost significant market share in the cheese market in Japan over the years to New Zealand and Australia, and to a small extent, to the US.

South-east Asia
Turning to the rest of Asia - Hong Kong, China, Thailand, The Philippines, Korea, Malaysia and Indonesia, they have a growing consumption of dairy products and a very strong growth in the fast food market. But, as noted above, the current financial crisis has delayed growth and dairy products are still not a part of their culture. This is a problem in times of financial or economic crisis because they will be willing to substitute or reduce the amount of dairy products they are eating - it is not a priority. Luckily some of the countries in this part of the world have made it a priority and the school lunch programme, for instance, is going to be continued. There is little apparent long-term impact on the current financial crisis overall for Asia. It is still very much a milk powder and whey market that will continue to be steady, but the cheese market is going to grow.

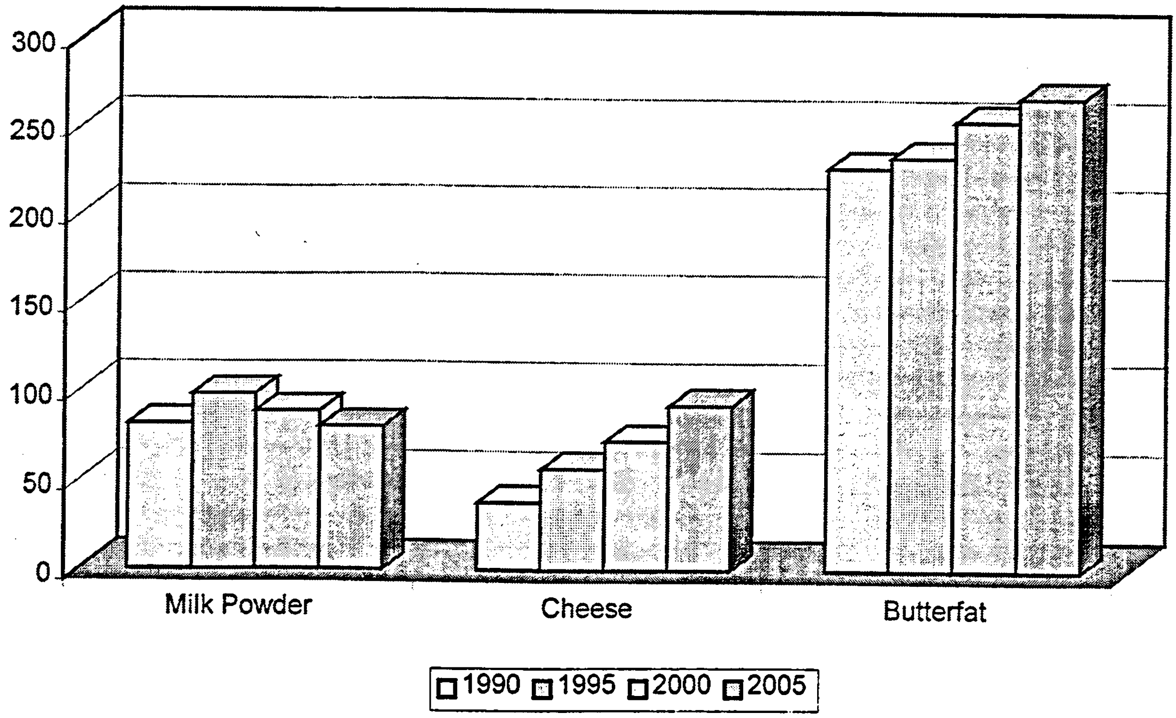
The Middle East

The Middle East is generally dependent on imports although Saudi Arabia has been increasingly putting high priority on being self sustaining in its dairy industry. There has been a rise in per capita income, but there is still political instability and market growth is declining compared to what it was in early 1990s. Oil prices are declining, domestic dairy production is increasing, and markets are very price sensitive. There is still growth in Middle Eastern markets, although growth is not as strong as elsewhere. It is going to be a commodity market, and a very price sensitive commodity market, although cheese, particularly feta and processed cheese, has definite possibilities. However, with such small markets, developments in one country can affect the regional market significantly: when Iran ceased importing feta cheese, for example, this completely destroyed Danish exports to the region.

Russia

In Russia, consumers are culturally accustomed to dairy products, particularly butter. The domestic industry is in crisis, which means that the Russian market will be dependent on imports. However, the Russian economy is unstable. There are payment problems, and reliable importers can sometimes be difficult to find. The Russian market is therefore particularly challenging, and not for inexperienced exporters. On the other hand, Figure 7 shows that there is growth there, and the cheese market is going to continue to grow together with the butterfat market.

Figure 7
Russia Dairy Product Consumption



SUMMARY AND CONCLUSION

Demand grows as a result of a strong economy, product awareness and acceptance, market access and availability of substitutes. The top tier emerging markets would be Mexico, Latin America and Japan. Middle tier markets would be the rest of Asia, the Middle East and Russia. As far as the future of the world dairy markets is concerned strong economies will increase demand and, as markets continue to grow and economies continue to grow, demand will continue to grow. With the movement towards freer trade as a result of the Uruguay Round, export subsidies are expected to continue to be decreased, and demand will probably be satisfied more regionally. This is already apparent with Oceania having taken a lot of the market in South-east Asia, the US poised to do quite well in Mexico, and Europe doing very well in the Middle East, the Central and Eastern European countries and Russia. There is enough growth though for all exporters, and the market will continue to grow, especially as those economies are helped to grow and get stronger.