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CAS Paper 37

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

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6 The European dairy market: a market analysis and identification of exploitable areas

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INTRODUCTION

The objective of this paper is to describe the background to the European market and to identify areas of opportunity. The figures that are presented have been compiled from extensive research into the consumption of all food, by category, in each of the 15 Member States of the European Union (EU). The paper presents an analysis of the market, its drivers and future prospects, and summarises from the market and consumer perspective the areas for exploitation.

FOOD MARKET OVERVIEW

In the food industry it appears that almost anything is possible and the dairy sector is certainly no exception. The market is highly diverse, competitive and full of apparent contradictions. Milk consumption is down, and indeed it is well-known that consumers are drinking less milk; however, milk is also up because, looking at total milk yields over the long term in the EU, these have been rising slightly. Butter consumption is down (as is apparent from the advent of margarine and the success of bread spreads), but, on the other hand, more products containing butterfat as an ingredient are being consumed. Semi-skimmed and skimmed milks show a similar problem.

Europeans, are becoming far healthier by consuming more semi-skimmed and skimmed milk than full-cream milk, but in fact at the same time they are purchasing more indulgent items containing cream such as luxury desserts, gateaux and super-premium ice-creams. Understanding these phenomena and the reasons behind them, is obviously vital for success in the market place.

Turning to the results of an analysis of the food and drink market as a whole, trends in total food consumption throughout the European Community of all food and drink between 1991 and 1996 are summarised in Table 1.

Table 1
EU¹⁵: total consumption of food and drink
 volume, by main sector

(million tonnes/billion litres, 1991-1996)

	1991	1996 ^e	change
Fresh and other produce	91.5	92.0	0.5%
Carcass meats	19.7	19.5	-1.1%
Meat and savoury products	9.6	10.0	4.1%
Fish and shellfish	7.5	7.9	5.8%
Cereal products	62.0	63.2	2.1%
Dairy products	49.4	50.6	2.4%
Confectionery	3.3	3.4	2.7%
Savoury snacks	1.1	1.3	14.9%
Soups, sauces, pickles, oils	9.0	9.4	3.6%
Baby foods	0.5	0.5	13.9%
Pet foods	3.7	4.1	11.1%
FOOD	257.3	261.9	1.8%
Beverages (dry weight)	2.4	2.5	2.1%
Soft drinks	54.4	64.1	17.8%
Alcoholic drinks	46.2	45.1	-2.5%
DRINK	103.1	111.7	8.4%
FOOD AND DRINK	360.4	373.6	3.7%

Notes: e = estimated; all tonneages rounded to nearest whole number

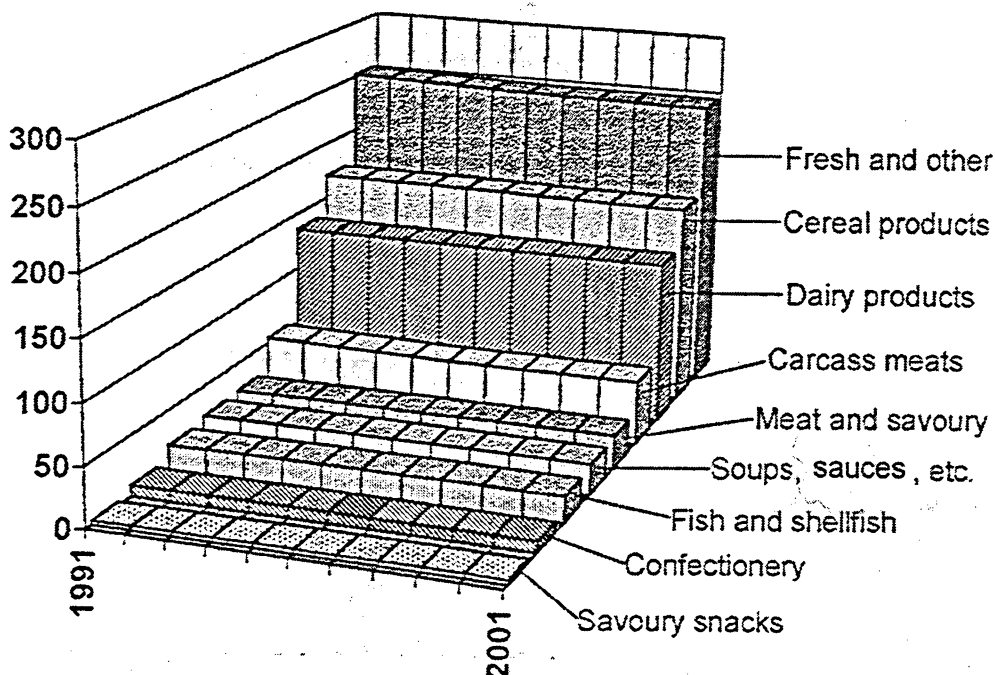
Source: RTS associates from national statistics, trade associations, trade estimates

The main point of note is that total volume consumption of all solid food has risen by only 1.8% and in fact when measured on a per capita basis, this represents a small decline. Total food and drink consumption has increased by only 3.7% and in fact most of that increase has come from the soft drinks sector. Dairy products constitute around 20% of total solid food consumption, but no product group in Europe, and dairy is no exception, is really growing. The market is basically flat. In a flat market such as that, what is important for the dairy sector is increasing its 'share of the diet'.

Figure 1 shows a profile in terms of an EU average kilograms per person per year of all the food consumed. It shows that fresh and other produce (fresh fruit, fresh vegetables, potatoes, and canned fruit and vegetables) take up by far the highest proportion of the diet followed by cereal products (bread, cakes and cereals) and then dairy products at around about 120 kg per person per year. Dairy products are followed by carcass meats, then meat and savoury products, soups, sauces and dressings, fish and shellfish, confectionery and, last of all, snacks. The main thing to note here is that apart from a slight decline in the consumption of fresh produce, there is not much activity here. What is happening is that within each of these sectors the market is becoming far more complex and far more competitive, as each manufacturer tries to fragment and segment their own market within each of those sectors. The key features of the overall food and drink market might usefully be summarised before considering dairy products in particular. First, the market is static, which is linked to low population growth: if the population is not growing then neither is food consumption. Secondly, within the market there is a growing

proportion of the elderly, who are not heavy volume consumers of food. However, added-value sub sectors such as convenience meals, snacks, indulgence products, image food and drinks, baby foods, pet foods and healthy foods, all of which are a sign of increasing affluence, have been performing well. Food expenditure has increased: expenditure is rising much faster than volume, meaning that the foods consumed have more added value in some way. And there are opportunities for adding value and convenience.

Figure 1
 EU¹⁵: per capita consumption of food, by main sector
 kilos per person, 1991-2001



Source: RTS associates from national statistics, trade associations, trade estimates.

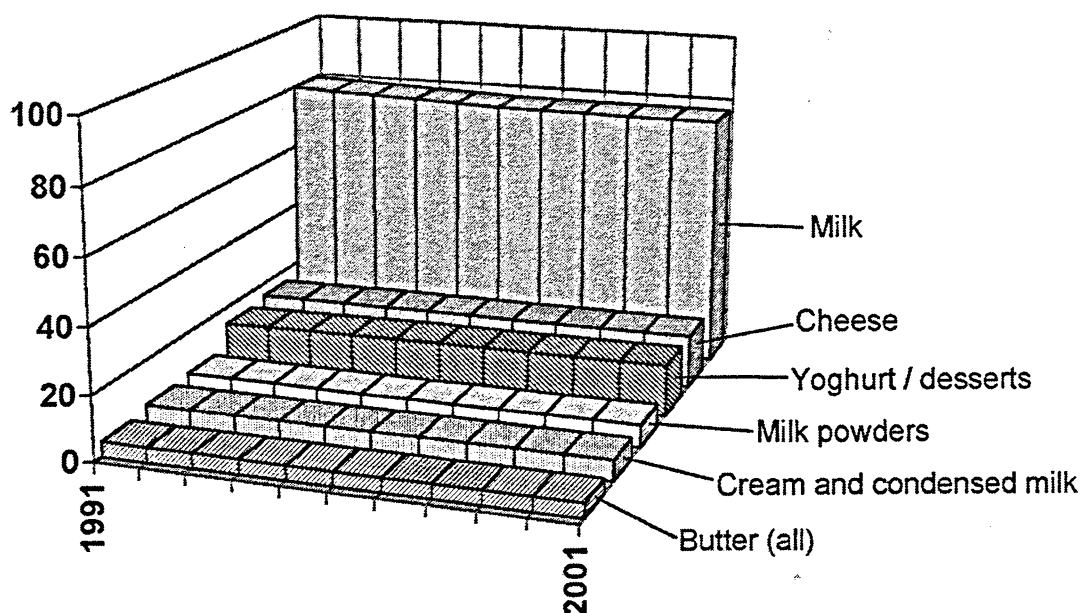
THE EUROPEAN DAIRY MARKET

European consumption of all dairy products during 1991-2001 is shown in Figure 2. It can be seen that milk dominates followed by cheese, yoghurts and desserts and so on, milk powders, cream and condensed milk combined, and lastly butter.

Average consumption of drinking milk is falling from 80.1 to 77.3 litres, that of cheese rising slowly from 15.9 to 16.2 kg, and that of yoghurts and desserts from 14.6 to 16.6 kg, whilst butter consumption is falling, from 4.6 to 4.4 kg.

Table 2 which shows European consumption of dairy products in 1992-1997 indicates that there has been a growth in volume of 0.2%. These changes are even more modest when measured on a per capita basis, and the overall growth in volume of 0.2% actually represents an overall average decline of 2% per person.

Figure 2
EU15: per capita consumption of dairy products, by main sector
kilos per person, 1991-2001



Source: RTS associates from national statistics, trade associations, trade estimates

Table 2
EU¹⁵: consumption of all dairy products
volume, by main sector

000 tonnes/m litres, 1992-1997

	1992	1997e	change
Drinking milk	29,130	28,850	-1.0%
Milk powders	2,597	2,461	-5.2%
Butter (all uses)	1,673	1,635	-2.3%
Cheese (all uses)	5,790	5,940	2.6%
Cream & condensed milk	2,285	2,293	0.4%
Yoghurt, desserts	5,315	5,682	6.9%
All dairy products	46,789	46,861	0.2%

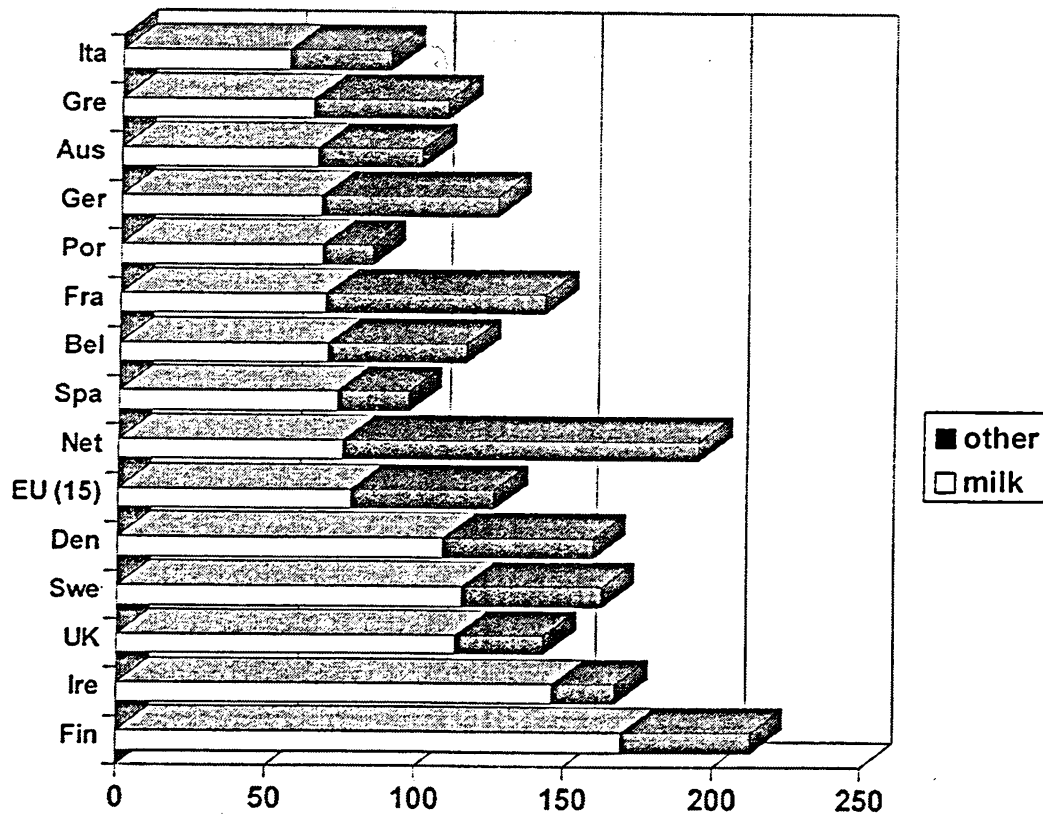
Notes: e = estimated; all tonneages rounded to nearest whole number

Source: RTS associates from national statistics, trade associations, trade estimates

Figure 3 contrasts the dairy consumption habits of each Member State. Finland is the highest consumer, the EU average being about 78 litres in terms of milk consumption, and about 48 kg of other dairy products per person. It is clear from Figure 3 that not only does the consumption of drinking milk vary widely across Europe, but so does the consumption of other dairy products, i.e. the value-added segments. It also shows that dairy consumption is still very much a northern

practice and, in general, declines the further south the country. The Netherlands is of note in that consumption of milk itself is not high, but that of milk products is.

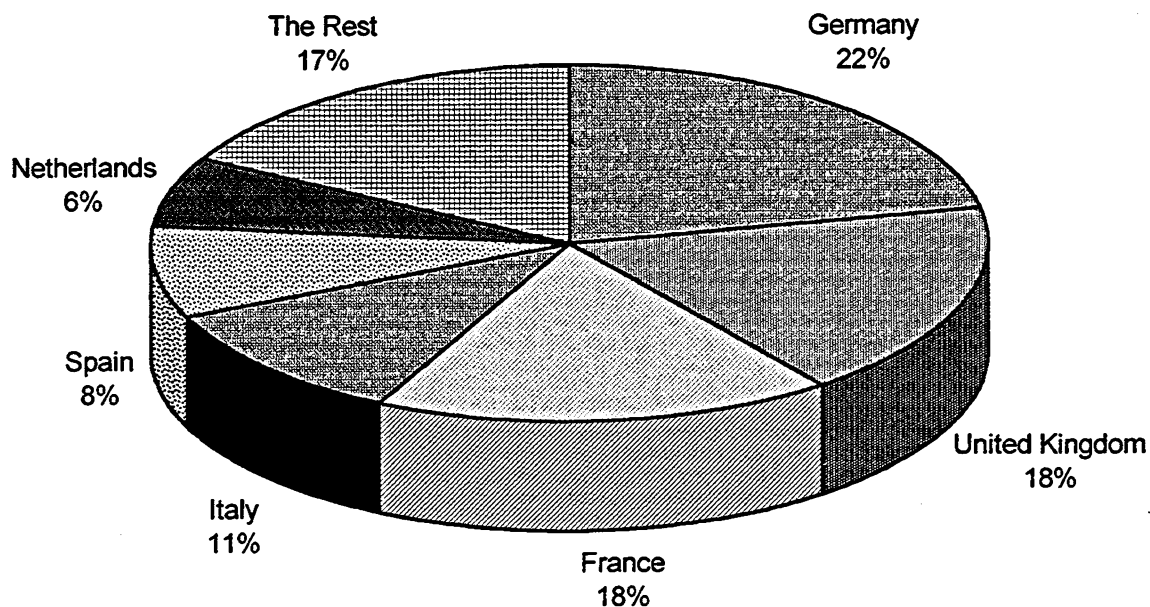
Figure 3
 EU¹⁵: per capita consumption of all dairy products, 1997
 kg/litres per person



Source: RTS associates from national statistics, trade associations, trade estimates

From Figure 4, which shows the volume share of consumption of all dairy products throughout the EU in 1997, it can be seen that Germany dominates with about 22% of the market. UK and France have about 18% each, then comes Italy (11%), Spain (8%), The Netherlands (6%) and then all the rest at 17%.

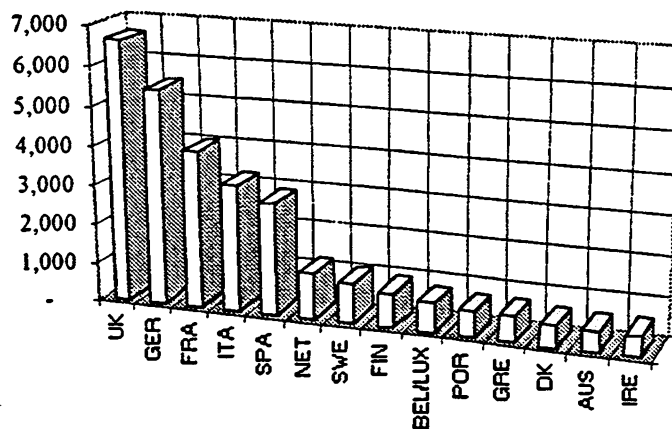
Figure 4
 EU¹⁵: share of consumption of all dairy products, 1997
 volume share



Source: RTS associates from national statistics, trade associations, trade estimates

Figure 5 which gives total consumption of drinking milk and milk drinks by country, shows that the UK dominates the drinking milk sector followed by Germany, then France.

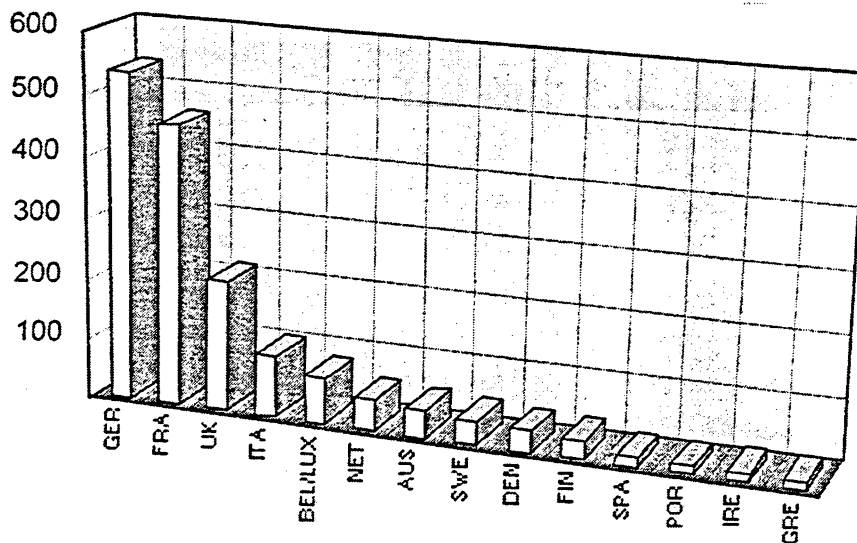
Figure 5
 EU¹⁵: consumption of drinking milk and milk drinks
 m litres



Source: RTS associates from national statistics, trade associations, trade estimates

The pattern of the use of butter across the European Member States, however, is different with Germany and France completely dominating usage, and the UK third but a very long way behind.

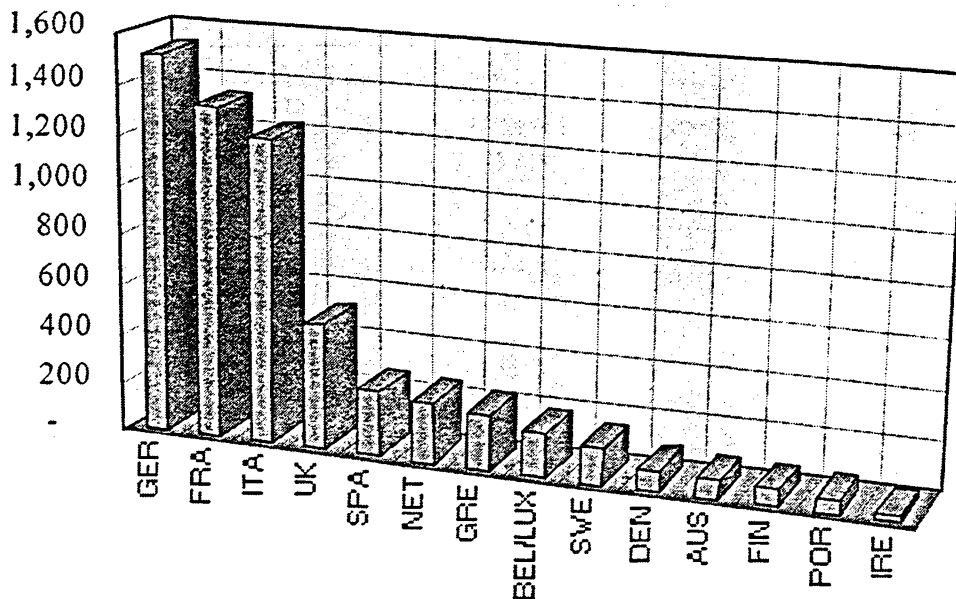
Figure 6
EU¹⁵: usage of butter
 000 tonnes



Source: RTS associates from national statistics, trade associations, trade estimates

With cheese (Figure 7), Germany and France dominate followed by Italy.

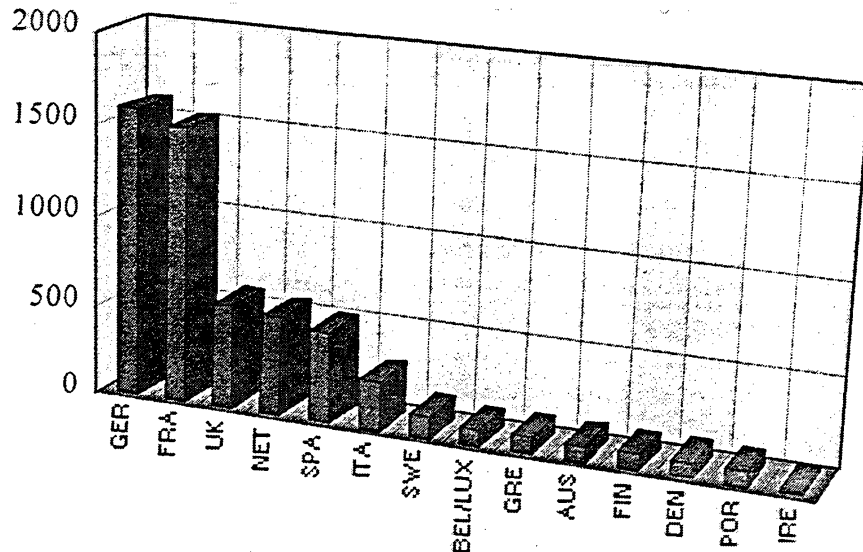
Figure 7
EU¹⁵: usage of all cheese
 000 tonnes



Source: RTS associates from national statistics, trade associations, trade estimates

Lastly, Figure 8 shows consumption of yoghurts and desserts. Again, Germany and France dominate with the UK a very long way behind in third place followed by The Netherlands. It might be argued that this sort of chart shows that there is massive potential for the further development of yoghurt and dessert dairy products in the UK, but it is doubtful whether that is true.

Figure 8
EU¹⁵: consumption of yoghurt and desserts
 000 tonnes

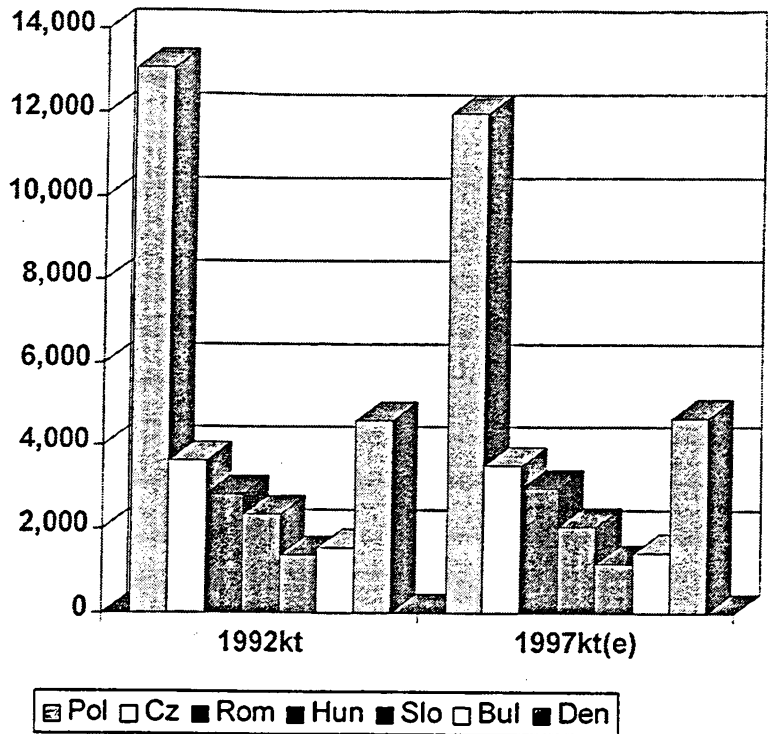


Source: RTS associates from national statistics, trade associations, trade estimates

Before going on to some of the trends and forecasts it may be worthwhile to comment briefly on the situation in Central and Eastern Europe. Milk production in certain Central and Eastern European states (Poland, The Czech Republic, Romania, Hungary, Slovakia and Bulgaria), and (for comparison) Denmark, is shown in Figure 9 for 1992 and compared with estimated values for 1997.

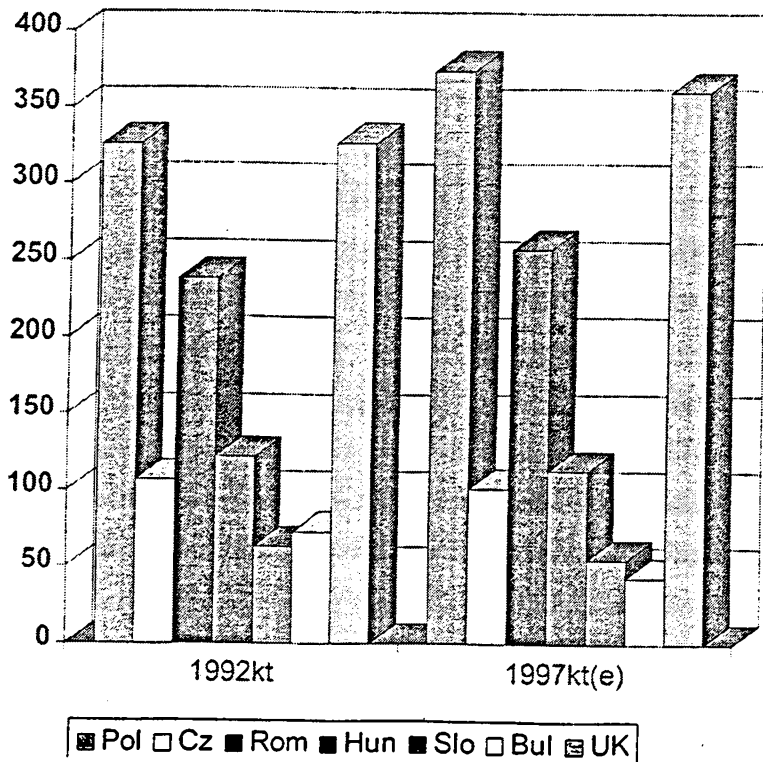
It is clear that the dairy market in Central and Eastern Europe has had severe problems since liberalisation, but there are signs that the markets are reviving in some states. Figure 10 compares cheese production in the same Central and Eastern European countries compared with the UK. Poland is actually a very strong producer of cheese, but again dairy production in most Central and Eastern European states has suffered since liberalisation: prices have risen thereby depressing sales, and the industry continues to suffer from serious underfunding, and poor infrastructure. Meanwhile, the withdrawal of subsidies has served to encourage, ironically, more peasant farming, to the detriment of the more efficient centralised dairies and co-operatives that did exist before the markets were liberalised. Poor quality and low yields are also an issue for the European market.

Figure 9
Central and Eastern Europe: milk production
 000 tonnes



Source: RTS associates from national statistics, trade associations, trade estimates

Figure 10
Central and Eastern Europe: cheese production
 000 tonnes



Source: RTS associates from national statistics, trade associations, trade estimates

TRENDS SHAPING THE FUTURE

This section summarises some of the trends that are influencing, and will continue to influence, the market. In terms of socio-economic change, new demands are being placed on the industry due to influencing factors such as:

- increasing affluence
- more working couples
- smaller households
- increasing number of unemployed or on fixed income
- increase in the elderly

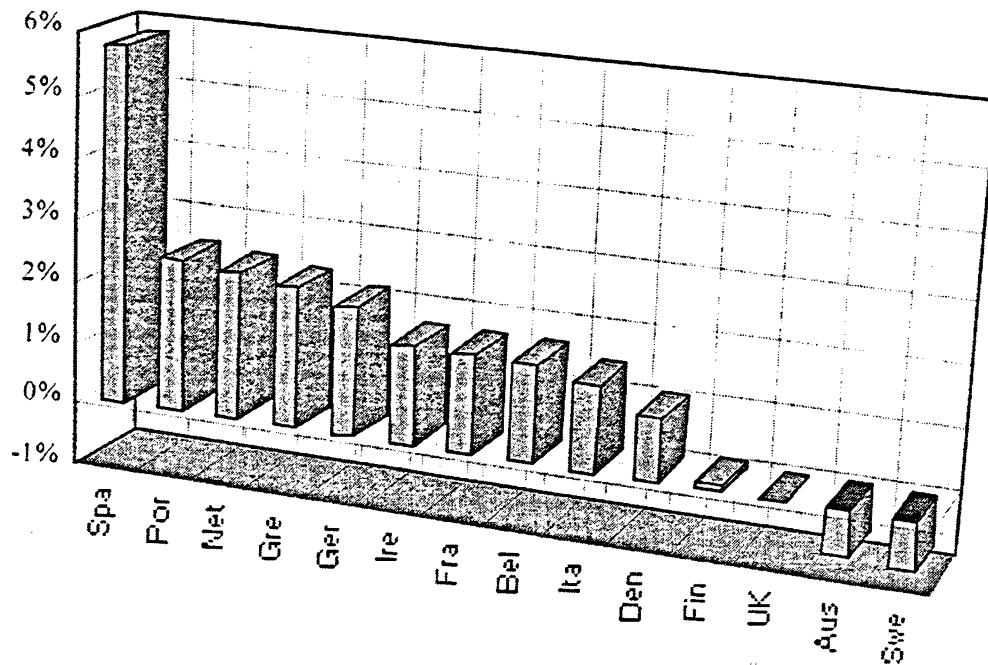
Increased affluence has increased the demand for freshness, convenience, foods that reflect fashion, healthier foods, more choice, new experiences and so on. With working couples, convenience, eating out, take-aways and convenience shopping start to become more important. At the same time, average household size is becoming far smaller, which leads to more demand for smaller portion sizes, and changes in shopping habits. However, throughout Europe there is still high unemployment and many on fixed incomes, and there is always going to be a demand for value, economy and discount shopping. Lastly, there is an increase in the numbers of the elderly, who have their own particular needs and demands. Each of these factors has its own influences on the market and of course on the types of product that are preferred and suppliers must remain aware and react to these demands.

In addition to the social economic factors there are of course macro influences on the market. These include such things as the single market and European monetary union (EMU). EMU will have a major impact, not so much because of its direct effect (just changing to another currency), but because of changing strategies of retailers and international manufacturers and the benefits it will bring to those best able to exploit it. For example, for those who are in so-called 'Euroland', the ability to set up a very highly efficient dairy plant in a low cost centre, enjoying the advantages of no exchange rates, must give them a tremendous advantage over indigenous UK dairy producers. At the same time, however, the world is becoming a smaller place. It is increasingly affected by trends, needs, and production of other countries. The issue of food safety, for one reason or another, is constantly to the fore, and of course influencing consumer choice. Mergers and acquisitions continue to change the face of the manufacturing sector. There is the issue of brands versus own labels and the influences, again, of more eating out, and more fast-food restaurants. The implication of the fact that the total market is flat, is simple: if consumers are going to eat out more often, then there is going to be a decline in the retail grocery sector. Dairy product suppliers need to be looking at those declines and looking at growth opportunities in eating out and fast food. Market fragmentation (more products, shorter life cycles) is also a problem suppliers. Finally, there are other issues such as concern for the environment, and lastly the influences of demographic and life-style changes. All of these must be accommodated if the industry is to continue to exploit the opportunities that exist in the market place.

MARKET FORECASTS

Figure 11 shows forecasts of percentage volume growth of all dairy products from 1997 to 2002. It should be noted that the apparently large increase in Spain amounts only to a 1% per year growth and is partly making up for recent declines. At the opposite end of the picture there are declines in Austria and Sweden, the UK is static and Finland just about static. Again, none of these increases in total dairy consumption is particularly significant.

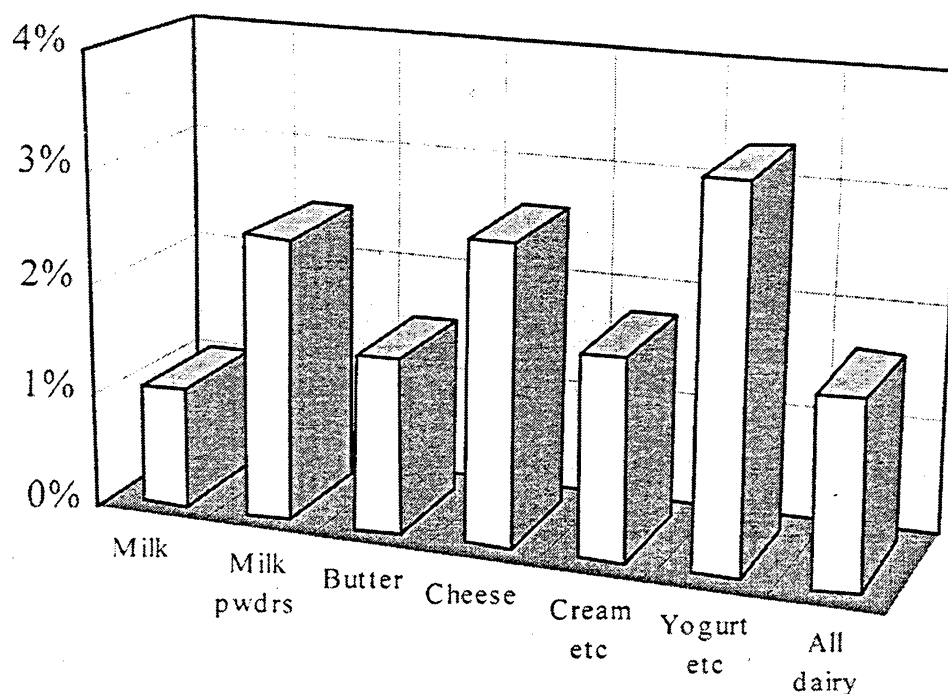
Figure 11
EU¹⁵: forecast growth of all dairy products, 1997-2002
% by volume



Source: RTS associates from national statistics, trade associations, trade estimates

Looking at those same forecasts in terms of product type (see Figure 12 and Table 3) there is around 1% growth in milk, with milk powders again redressing some balance of previous lost market with butter, cheese, cream, yoghurts and desserts and total dairy products. Again, even yoghurts and desserts will, over the next five years, fail to live up to the expectations of some. They have been growing rapidly throughout Europe but are now clearly showing signs of stagnating in many European countries.

Figure 12
EU¹⁵: growth in consumption of dairy products, 1997-2002
 % by volume



Source: RTS associates from national statistics, trade associations, trade estimates

Table 3
EU¹⁵: forecast consumption of all dairy products
 volume, by main sector

000 tonnes/m litres, 1997-2002

	1997e	2002f	change
Drinking milk	28,850	29,152	1.0%
Milk powders	2,461	2,522	2.5%
Butter (all uses)	1,635	1,660	1.5%
Cheese (all uses)	5,940	6,096	2.6%
Cream & condensed milk	2,293	2,334	1.8%
Yoghurt, desserts	5,682	5,871	3.3%
All dairy products	46,861	47,635	1.7%

Notes: e = estimated; f = forecast; all tonneages rounded to nearest whole number

Source: RTS associates from national statistics, trade associations, trade estimates

While the total market is forecast to increase by only about 1.7% in volume, in value terms (see Table 4) the forecast is an increase of 6.1%, clearly a much greater increase and a much more interesting increase than the volume situation. This is shown graphically in Figure 13 which compares volume growth with value growth by dairy sector. In every case the value growth for each sector is expected to increase faster than volume. For example, with drinking milk, with the advent of more

specialist milks, more organic milk, and more milk drinks, the value of the sector will be pushed up whilst the volume itself will not increase very much.

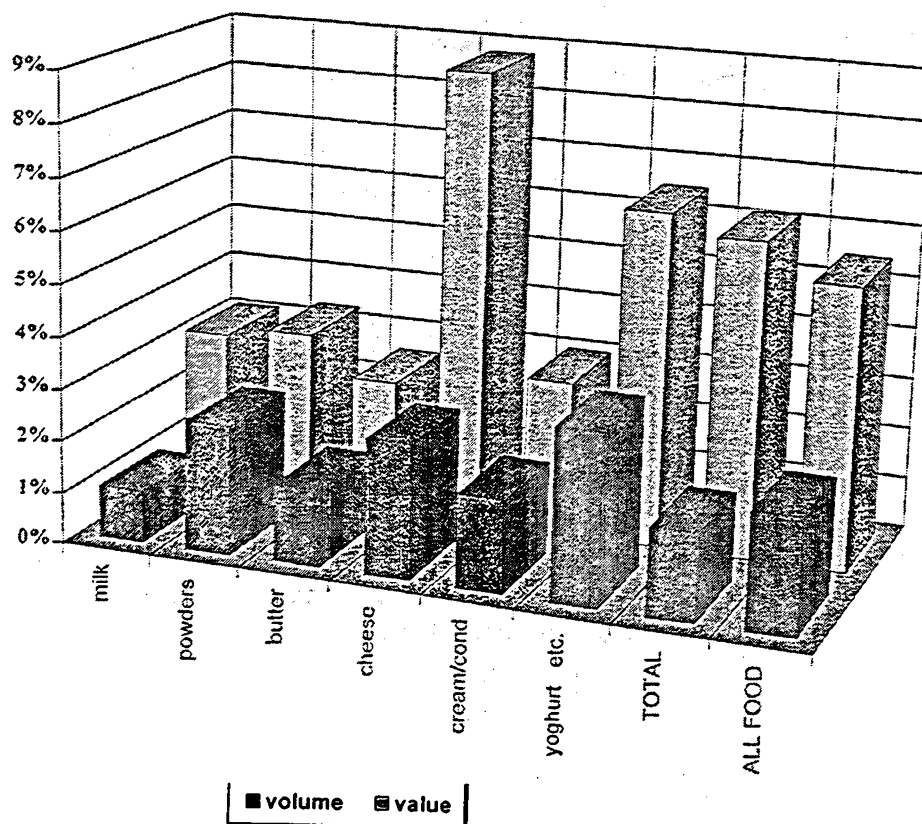
Table 4
EU¹⁵: forecast expenditure on dairy products
 value, by main sector

\$bn

	1997e	2002f	change
Drinking milk	\$20.4	\$21.1	3.1%
Milk powders	\$10.3	\$10.6	3.3%
Butter (all uses)	\$10.1	\$10.4	2.5%
Cheese (all uses)	\$52.3	\$56.9	8.8%
Cream & condensed milk	\$6.2	\$6.4	3.0%
Yoghurt, desserts	\$14.8	\$15.8	6.5%
All dairy products	\$114.1	\$121.1	6.1%

Notes: e = estimated; f = forecast; all values rounded to nearest decimal point
 Source: RTS associates from national statistics, trade associations, trade estimates

Figure 13
EU¹⁵: forecast change in consumption of dairy products
 volume and value, by sector
 % change, 1997 v 2002



Source: RTS associates from national statistics, trade associations, trade estimates

So, the indication is that for the average European, the choice of food is becoming much less dependent upon the volume eaten but more on the quality and the image of the food that consumers are prepared to pay for. In other words, in the future consumers will not be eating more food or more dairy products, but the dairy products they do eat will be in some way better, and of course the key is predicting what 'better' is actually going to be and translate into. There is already evidence that consumers are willing to pay more for foods that are convenient or healthy, organic, indulgent, exotic, high quality, or simply quick to prepare. These trends are very much likely to continue. In fact, Table 5 shows some of the ways in which value might be added to dairy products. Value can be added through quality, convenience, health, new experiences, through the product being natural, luxury, or in keeping with lifestyle or consumer image. This list is not exhaustive.

Table 5
Adding value - some ideas

<p>quality</p> <ul style="list-style-type: none"> superior ingredients / flavour product presentation traditional values freshness branded / place of origin packaging 	<p>new experiences</p> <ul style="list-style-type: none"> new sources new varieties Imported
<p>convenience</p>	<p>Natural</p> <ul style="list-style-type: none"> organic farm-produced stated origin
<ul style="list-style-type: none"> for snacking / ready-to-eat packaging / storage / re-sealable meal assembly 	<p>Luxury</p> <ul style="list-style-type: none"> gourmet indulgent
<p>healthier</p> <ul style="list-style-type: none"> added fibre, low lactose vegetarian low fat, "filled" vitaminised natural nutritional benefits 	<p>lifestyle / image</p> <ul style="list-style-type: none"> for entertaining for busy people fit and healthy fun

EXPLOITABLE AREAS

What are the exploitable areas for dairy products in Europe? It has been shown that opportunities can be exploited by adding value in a variety of ways that are relevant to today's consumer: healthy, organic products (which may be one of the biggest growth sectors), for example. It is also important not to underestimate the power of product imagery and presentation. This is especially important if dairy products are to be maintained as being relevant to changing consumer needs and/or new lifestyles. The industry must continue to make dairy products convenient for the consumer to use (as snacks or meals in their own right). It is necessary to understand the marketplace being targeted before starting development programmes.

It is ironic that so many dairy products are imported into the UK which is one of the world's most efficient dairy producers. This suggests that it is in development and effective marketing where markets can be won or lost. So, the industry must continue to look for opportunities. If it cannot compete on price, it must compete on quality, presentation, or a point of difference.

There is also a lot of evidence that dairy products are being increasingly used as ingredients in other prepared foods and luxury items. An example here is cheese which, apart from pizzas, is used in many products. Cream and butter are used by the food processing industry to create more luxury or added-value products. So, the industry needs to measure and exploit these opportunities.

If the industry is able to grow in this static market, it will need to identify and develop new areas but will increasingly need to take share from its competitors, and understand and exploit the advantages of EMU. There will be a penalty for those who do not - even (or especially) in countries outside 'Euroland'. The industry should also continue to assess the scope for joint ventures or partnerships and added-value products in Eastern Europe, although growth will be slow.

Finally, as the market becomes increasingly competitive, diverse and faster-changing it will be essential to concentrate on production technology, efficiency and company structures designed to meet the changing market. There will be a need to ensure that dairy products reflect and satisfy the contemporary needs of the consumer, the caterer and the retailer. Although the total market may be flat, there will still be successes in areas of decline and failures in sectors of growth. The key is to make a thorough assessment of the market and be organised to be able to exploit the opportunities.

CONCLUSIONS

In conclusion, there will be even greater competition in this relatively static market with many trying to tap into new areas of growth. All food and drink products should be viewed as competition. A high rate of new product development will be required to keep pace with competitors and the demands of retailers and consumers and the industry will need to cope with increasing product diversity and shorter product life-cycles.

Opportunities arising from EMU should be exploited, especially those in the euro zone and strategies should be developed to cope with price transparency and other EMU phenomena.

The most exciting sectors will be in the development of product imagery, product packaging, presentation and technology and the use of dairy products as food ingredients.

Finally, as the market becomes even more crowded, competitive and faster-changing, it is essential to ensure all products reflect and satisfy the contemporary

needs of the consumer, caterer and retailer, and it is mainly through the *structure and organisation* of the industry that these goals will be met effectively.