Is the dairy investment fund spread too thinly?

by Diarmaid Ó Corrbuí

MINISTER for Agriculture and Food, Mary Coughlan, recently announced major grant awards totalling €114m as part of the Dairy Investment Fund to 12 dairy processing companies. This should trigger a gross capital investment of over €286m by those successful companies.

The objectives of this fund are to reinvigorate the sector and contribute to the development of a modern, competitive, innovative, market focussed and highly efficient dairy processing sector in Ireland. The scale of investment being proposed is impressive and represents a major vote of confidence by those dairy processors in the future of their industry and in the ability of their individual companies to be competitive and successful in the global dairy markets. It is also a recognition by the industry on the critical need to significantly increase the value-added content of their products and to improve process efficiency.

THE Prospectus report on the dairy processing sector, published in 2003, highlighted the fact that the dairy production and processing sectors in Ireland are highly fragmented in terms of the number of milk suppliers and processors. This fragmentation is important in the context of an industry that is highly export dependent with 80-85pc of its dairy products being exported. It is competing in international markets against much larger enterprises in New Zealand, Denmark and the Netherlands, who are increasing their scale at a faster rate than Ireland. The report stressed the need for the industry to address the growing competitive challenges and the urgent necessity for the dairy processing sector to:

- Achieve significant cost efficiencies through plant rationalisation and economies from increased scale and process efficiency of the remaining plants;
- Provide the scale and capacity to invest and avail of existing and emerging product and market opportunities;
- Reduce the level of dependence on commodity type products and increase the value-added content of manufactured dairy products;
- Get quickly to a position where the industry has major players who have the scale, cost competitiveness and resources to compete successfully against the large-scale international competitors such as Fonterra, Arla and Campina.

In the four years since the Prospectus report, very little has happened on the consolidation and rationalisation agenda. There has been some rationalisation of plants and co-operation agreements between a few processors in terms of product and processing capacity. There have been a number of new chief executives appointed and an apparent increased willingness amongst certain players to explore cooperation opportunities. But, overall, the structure of the industry remains unchanged.

In terms of product mix and improving the value-added content, there also has been some progress. There is an increased emphasis and investment in R&D and product development. In product volumes terms, the biggest change has been in the area of cheese with production increasing from 120,000t in 2001 to 132,000t in 2006. The output of butter has also increased significantly in the 5-year period from 128,000t in 2001 to 142,000t last year.

CURRENT dairy markets are very strong and are very much a seller's one. Globally, only around 7pc of dairy products are internationally traded, so relatively small shifts in the supply and demand dynamic can have a significant impact on prices. Prices being achieved currently are good. The price, for example, being obtained for skim milk powder is around €2,850/t, up

from €1,900/t a year ago, while the price for whey powder has doubled over the same period going from €675 to €1,350/t. The factors contributing to this positive price position include a reduction in output in Australia due to drought, a reduced rate of output growth in New Zealand and increased demand for dairy products in countries such as China.

The strong current market conditions, while very beneficial to the processors and the farmers, has a danger in removing the sense of urgency that is needed to address the longer term strategic competitive issues facing the industry. We have to ask ourselves if we really believe that it will be sustainable for the Irish dairy processing industry to continue to compete in international markets with more than 12 dairy processors against our major competitor countries who are dominated by one or two mega players in those countries.

In a processing sector so dependent on exports, is it the most efficient use of resources to have a sector with 12 or more chief executives, management teams and administrative systems?

We also need to ask: what is the best future role of the Irish Dairy Board and what contribution should it play in creating a competitive, innovative, market focussed and highly efficient dairy processing sector in Ireland?

The dairy investment fund and the knock-on investment by dairy companies is a very welcome development, particularly the strong focus in improving product quality and efficiency. I am, however, somewhat surprised at the spread of awards with 12 companies being successful in obtaining funds. I would like to have seen more concentration with bigger awards to fewer companies and greater encouragement for rationalisation and co-operation between processors. It was, however, good to see funding for specialist companies like J & L Grubb and Glenisk as the industry will always need a number of innovative and niche players in addition to the mega players.

Current positive market conditions have given rise to a strong sense of optimism and confidence in the dairy sector, as witnessed by the proposed capital investment in the processing sector of almost €300m.

THE expected pain following the CAP reforms and proposed WTO agreements has not yet materialised, so this has taken some of the pressure off the industry to seriously face up to the need for the rationalisation in the number of processing plants, to reduce the number of processors and to be ruthless in reducing costs and improving efficiencies. While the scale of capital investment planned by the sector under this funding programme is impressive, one can't but wonder if it will be as effective as it could be, given the spread of investment initiatives involved.