

AgriPolicy
Enlargement Network for Agripolicy Analysis

**AN ASSESSMENT OF THE
COMPETITIVENESS OF THE DAIRY FOOD CHAIN
IN SLOVENIA**

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1 Introduction

The study considers the state and performance of the dairy chain in Slovenia. It is based on the report 'Structure and competitiveness of the milk and dairy supply chain in Slovenia' (Volk et al., 2006) prepared within the Sixth FP SSA-533705 Project 'Agro economic policy analysis of the new member states, the candidate states and the countries of the Western Balkans' and on the report 'Analysis of the dairy chain in Slovenia' (Van Berkum, 2007) prepared in the framework of the Slovenian-Dutch Twinning Project SIO4-AG-06 'Helping farmers and supporting institutions to quota regulations in adjustment to the EU supply management resources'. The state and performance analyses of the sector are updated and used to estimate the competitiveness of the Slovenian dairy chain, to identify key constraints to competitiveness and possibilities for its improvement.

The report is divided into four sections. Firstly, an overview of the present situation and conditions in milk production and processing in Slovenia is provided. Next section further elaborates on the issue by evaluating factors, which influence the competitiveness and efficiency of the milk chain. Based on these analyses, the sector's strengths and weaknesses, opportunities and threats are identified. The report concludes with some suggestions to policy options (EU based) to help prepare the dairy chain for the challenges ahead.

2 Overview of the sector

2.1 Sector definition: sector components and importance

2.1.1 Production and value added

Milk production is one of the main sub-sectors of Slovenian agriculture. It has traditionally been concentrated in the relatively small-scaled family farms. The majority of milk produced is delivered to dairies for processing through well organised milk collection system.

In the last decade the contribution of milk sector to the Gross Agricultural Output (GAO) fluctuates between 12.4% (1997) and 16.9% (Table 1). After some decrease in 2004 a slightly upward trend has appeared over the last three years. The share of 15.9% in 2006 is a bit higher than that of the EU-15 as a whole, in which milk accounted for 13.8 % of GAO (13.7% in EU-27). The milk shares in individual states range from 6.7% in Spain to 33.5% in Luxembourg¹.

The fluctuations in contribution of the sector to the Slovenian GAO during the analysed period can be partly explained by the changes in milk production and prices and partly by fluctuations in GAO of crop products. In the years 2001, 2003 and 2006 when the shares of dairy sector were the highest, the crop production was strongly affected by bad weather conditions (severe droughts, storms, flood etc.) consequently leading to sharp decrease in crops GAO.

¹ http://ec.europa.eu/agriculture/agrista/2007/table_en/311.pdf

Table 1. Share of milk production in total Gross Agricultural Output (GAO); 1997-2007

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Total GAO (EUR mill.)	1032.1	1007.3	957.7	981.3	981.6	1073.5	960.1	1093.5	1065.3	1066.1	1113.4
Dairy production GAO	127.5	119.8	128.0	149.7	155.3	158.1	164.4	172.7	162.0	157.4	164.3
Share of milk production in GAO (%)	12.4	14.9	16.2	16.1	16.7	16.1	16.9	14.4	15.4	15.9	14.7

Source: EUROSTAT, Economic Accounts for Agriculture

Importance of milk production at the primary level is somehow not entirely reflected upstream since the dairy industry is only the fourth largest sub-sector of the Slovenian food processing industry. In terms of value added it ranks after Production of other food products (15.8), Meat processing (15.1) and Beverage production (15.9) sub-sectors. The sector is dominated by three large dairies, which are, however, still rather small in comparison with foreign competitors.

In the year 2007 the companies in dairy processing sector generated 36.8 million euros of Gross Value Added (GVA), which is 7.4% of the total value added of the Slovenian food and beverage industry (Table 2). Since the year 1997 when the dairy industry contributed more than one tenth of the total food processing industry GVA this share has contracted substantially.

Table 2. Share of Gross Value Added (GVA) of the dairy industry in total food and beverage industry GVA; 1997-2007

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Total GVA in food and beverages industry (EUR mill.)	422.6	440.8	450.8	449.1	454.1	486.7	487.2	452.1	458.0	462.8	498.8
Dairy industry GVA (EUR mill.)	43.4	43.2	39.9	41.5	43.9	47.4	44.2	31.2	34.3	23.2	36.8
Share of GVA of the dairy industry in total food and beverage industry GVA (%)	10.3	9.8	8.9	9.2	9.7	9.7	9.1	6.9	7.5	5.0	7.4

Source: AJPES - Agency of the Republic of Slovenia for Public Legal Records and Related Services

This significant decrease in GVA of the Slovenian dairy industry is largely connected with changes in the economic environment caused by EU-Accession (see section 3.2).

2.1.2 Product flows within the sector

In the year 2007 124,190 dairy cows were reared on 19,200 milk producing agricultural holdings in Slovenia. Total raw milk production amounted to 666,500 tonnes of which approximately 80% was delivered to the milk collection stations and the rest was used or sold on farm. Most of the on-farm use of milk is for farm animal feed and only smaller share is consumed on farm or sold directly from the farm in the form of fresh milk or processed products. In last decade, sales to dairies have been constantly on the rise indicating increase in commercial orientation of producers.

The figure 1 below summarises key information about the Slovenian dairy supply chain and the product flows.

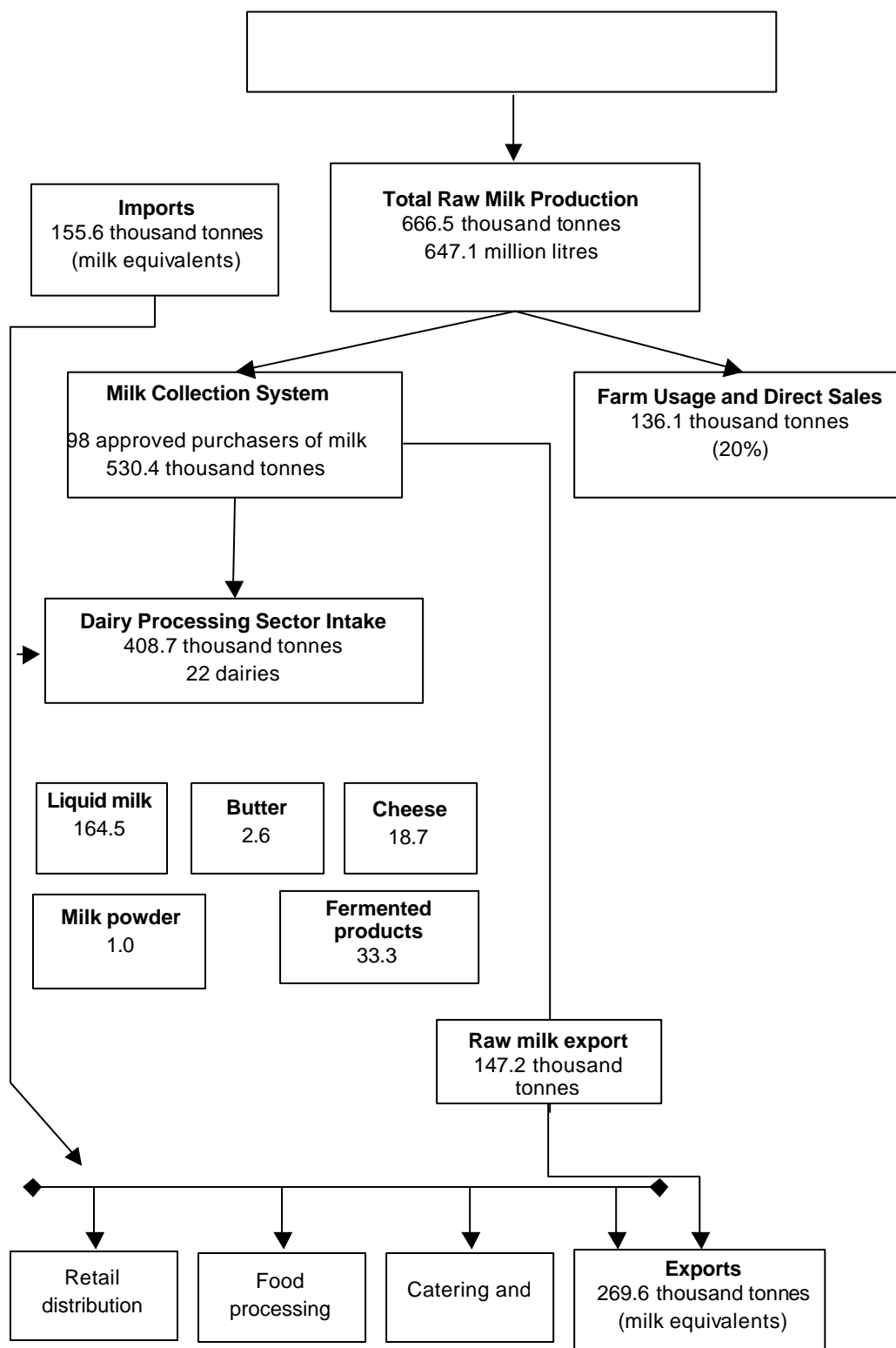


Figure 1. Overview of the Slovenian milk sector and milk flows, 2007

Slovenia has a well developed and smoothly operating system of milk collection. It is largely organised through cooperatives but in some cases dairies themselves collect milk. In 2007,

there were 98 registered and approved purchasers of milk of which 82 were cooperatives². In the case of large farms, milk is collected directly, whereas smaller producers bring their milk to common collection stations on the milk route. Before accession, milk was purchased only by domestic dairies, but afterwards some producers (cooperatives) reoriented their sales of raw milk to the foreign processors. In 2007, 530,400 tonnes of milk were delivered for processing, of which around 147,200 tonnes (28%) were sold directly to Italian processors. The rest was delivered to domestic dairies. Beside raw milk purchased from Slovene suppliers domestic dairies processed also some milk imported from neighbouring countries. The main products of the Slovenian dairies are fresh milk and fermented dairy products, cream and cheese.

2.2 Structural features of the dairy supply chain: present situation and trends overtime

2.2.1 Industry structure at primary level

Since the mid-1990s, the milk sector in Slovenia went through rapid structural changes including a continuous decrease in the number of producers and increasing average herd size per holding (Figure 2). However, after 2003 these structural changes have slowed-down or even stopped.

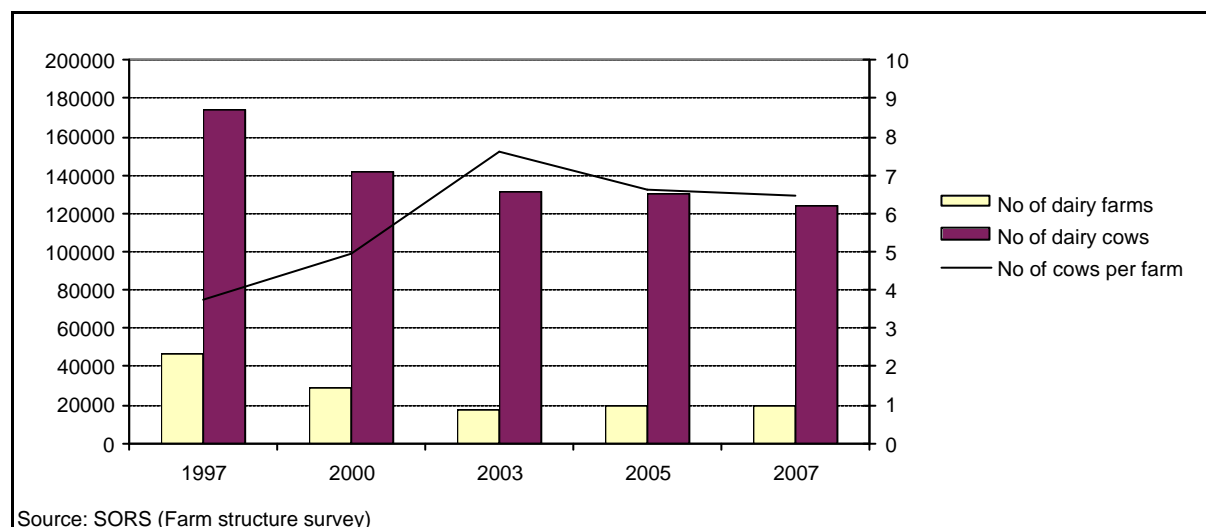


Figure 2: Changes in number and average herd size of dairy farms in Slovenia; 1997-2007

According to the most recent farm structure survey (2007), the average number of dairy cows per holding was 6.5 (Table 3), which is a notable increase in comparison to 3.8 cows per holding in 1997 but smaller number than in 2003 (7.6 cows) and 2005 (6.6 cows). The size distribution is still very different from the EU-15, where the average number is around 35 animals per holding, ranging from about 10 in Austria to 85 in Denmark³.

In Slovenia more than 40% of the dairy holdings had one or two cows only, and about 80% has less than 10 dairy cows. Only less than 7% of holdings kept more than 20 dairy cows and

² The Agency of the Republic of Slovenia for agricultural markets and rural development (ARSAMRD) website

³ Eurostat data for 2005

they accounted for one third of the total national herd. Nevertheless, in Slovenia, small holdings still dominate milk production.

Table 3. Size structure of the dairy farms; 2007

Specification	FARMS			COWS			Average head / farm
	No. of farms	% of total	Cum. %	No. of head	% of total	Cum. %	
TOTAL	19,196	100.0		124,190	100.0		6.5
1 - 2 heads	8,044	41.9	41.9	11,193	9.0	9.0	1.4
3 - 4	3,535	18.4	60.3	11,882	9.6	18.6	3.4
5 - 9	3,702	19.3	79.6	24,387	19.6	38.2	6.6
10 - 14	1,772	9.2	88.8	20,623	16.6	54.8	11.6
15 - 19	908	4.7	93.5	15,083	12.1	66.9	16.6
20 - 29	759	4.0	97.5	17,832	14.4	81.3	23.5
30 - 49	365	1.9	99.4	13,291	10.7	92.0	36.4
50 - 99	104	0.5	99.9	6,474	5.2	97.2	62.3
>= 100 heads	8	0.0	100.0	3,425	2.8	100.0	428.1

Source: Statistical office of the Republic of Slovenia (SORS), Farm Structure Survey

Since Slovenia is a member of the EU, milk production is subject to the EU milk quota system. In compliance with the Accession treaty Slovenia had to introduce the milk quota system in quota year 2005/2006 (1 April – 31 March). Initial national reference quantity, agreed in negotiations was 560.424 tonnes of milk (table 4). Farms with the smallest herds of dairy cows, which produce milk predominantly for their own consumption, had not applied for quota. This means that the number of farms with quota is far smaller than total number of dairy farms. In the first quota year 2005/2006 quota was allocated to 12,747 farms only, of which 10,133 asked for quota for delivery to dairies and the rest for direct sales (table 4). In next years this number went down, while allocated quota increased. At the end of the marketing year 2007/2008 (1.4.2008) less than 10,800 holdings were included in quota system. Therefore only slightly more than half of all holdings with dairy cows (19,200) are market producers. Out of them, about 70% is located in areas with less favourable conditions for agriculture (mostly hilly regions) and they hold more than 60% of total quota allocated.

Table 4. Number of producers and milk quota allocation (tonnes); 2005-2008

	1.4.2005			1.4.2006			1.4.2007			1.4.2008		
	Delivery	Direct sales	Total	Delivery	Direct sales	Total	Delivery	Direct sales	Total	Delivery	Direct sales	Total
No. of producers	10,133	2,614	12,747	9,630	2,660	12,290	9,168	2,455	11,623	8,712	2,098	10,810
Allocated quota	498,456	20,131	518,587	516,677	21,155	537,832	550,646	19,087	569,733	543,639	14,415	558,054
National reserve	17,287	24,550	41,837	16,536	6,056	22,592	2,870	4,035	6,905	23,567	6,549	30,116
Nat. ref. quantity	515,743	44,681	560,424	533,213	27,211	560,424	553,516	23,122	576,638	567,206	20,964	588,170

Source: Agency of the Republic of Slovenia for Agricultural Markets and Rural Development

After the introduction of the milk quota system the average quota size for deliveries has increased from 49 tonnes per holding in 2005/2006 to over 60 tonnes per holding in 2007/2008, indicating that the consolidation process in dairy sector is still going on.

In the quota year 2006/2007, Slovenia was granted an additional quota for restructuring and in marketing year 2008/2009 national reference quantities in all Member states has been increased by 2%. Therefore, the quotas in Slovenia have not yet been fully allocated. In April 2008, there was still about 30,000 tonnes in the national reserve, giving possibility for further milk production growth.

2.2.2 Industry structure at processing level

In 2007 there were 22 enterprises registered in the dairy processing sub-sector (DA-15.5) and employing 1,254 workers. Seven of them have actual processing capacities of notable quantities, the rest are mainly importers, distributors or representatives of foreign companies. The size distribution of the Slovenian dairy enterprises by the number of employees presented in the table 5 shows that the majority of the enterprises (17) classify in the smallest size band with less than 49 employees, but actually 14 out of them reported less than 5 employees in 2007. On the other hand there is only one enterprise with over 500 employees and another two with 100 to 249 employees.

Table 5. Size distribution of dairy industry, in number of employees; 2007

Size band, in numbers of employees	Number of enterprise
0-49	17
50-99	2
100-249	2
250-499	0
Over 500	1

Source: AJPES - Agency of the Republic of Slovenia for Public Legal Records and Related Services

This clearly indicates that the industrial structure in Slovenia is rather concentrated. The largest three operators process about 90% of the raw milk intake.

Table 6: List of larger dairy companies with their milk intake; 2007

Name of the company	Ownership	Estimated milk intake per day	
		In tonnes	As % of total intake
Ljubljanske mlekarne	Joint stock company	573	51
Mlekarna Celeia	Limited liability	244	22
Pomurske mlekarne	Joint stock company	202	18
Agroind Vipava	Joint stock company	42	4
Mlekarna Planika Kobarid	Limited liability	40	3

Source: Company sources

The largest dairy Ljubljanske mlekarne purchased around 51% of the raw milk in 2007, while the second Mlekarna Celeia accounts for about 22% (table 6 and figure 3). The third dairy Pomurske mlekarne has acquired about 18%, which is a notably smaller share than in the previous years, when that enterprise was the second largest in the sector. The reduction is due to performance difficulties which have led to ownership restructuring and management changes.

The share of ‘other purchasers’ is varying around one tenth of domestically processed raw milk. However, among smaller milk processors there are also some rather stable and fairly competitive enterprises. One of them is a specialised ice-cream producer with notable export performance. The other is a producer of niche fermented products (kefir) and has recently registered its premises for processing organic milk.

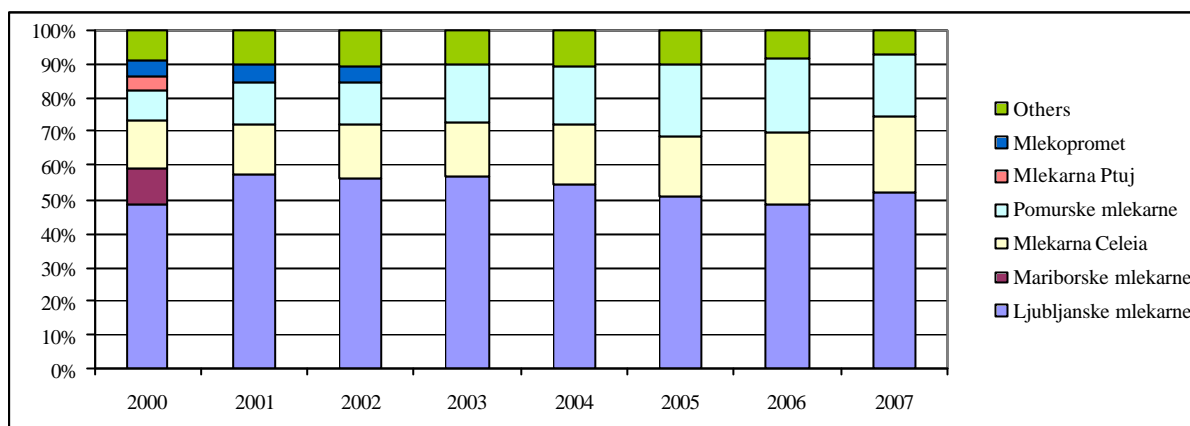


Figure 3. Intake of raw milk by Slovenian dairies in the years 2000-2007 (estimations)

As far as the ownership structure of the large Slovenian dairies is concerned agricultural cooperatives hold important positions, beside capital investment funds and to a very limited degree parastatal capital funds. In Mlekarna Celeia the share of cooperatives is around 75% whereas Agroind-Vipava and Planika are entirely owned by cooperatives. The share of cooperatives in Ljubljanske mlekarne is smaller, and investment funds hold about 50% of the shares, after the recent disinvestment of the parastatal capital funds.

So far, there is no foreign capital in Slovenian dairy industry, which is in line with general low presence of foreign investments in the economy.

2.3 Production, consumption and trade developments

In the table 7 supply and demand balance sheets summarise the key developments in production, consumption and trade with milk and dairy products in the period between 1997 and 2007. The key observation from the balance sheet is fluctuation in production and consumption of milk with a slightly upward trend, growing exports and imports of dairy products in last years and constant but fluctuating surplus, since milk production exceeds domestic consumption during the entire period.

Table 7.: Supply/demand balance sheet on dairy products (in 000 tons of raw milk equivalent)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Production	586.7	599.3	633.8	648.6	652.8	657.2	661.7	650.4	659.0	642.3	666.5
Imports	22.8	24.2	27.0	30.7	28.0	36.1	44.6	49.7	83.9	139.3	155.6
Exports	76.2	102.0	116.9	104.9	119.7	115.9	141.1	126.2	165.6	246.5	269.6
Stock variation	-0.4	1.9	-2.9	3.0	0.6	10.8	-7.7	2.4	-4.6	0.0	-1.8
Supply available	533.7	519.6	546.8	571.5	560.5	566.6	572.9	571.4	582.0	535.0	554.2
Human consumption	431.7	436.4	440.4	462.1	455.3	470.5	476.3	482.4	492.6	448.8	461.3
Average consumption per capita (kg)	217.3	220.1	221.8	232.2	228.6	235.7	238.5	241.6	246.2	223.4	228.5
Self-sufficiency rate (%)	109.9	115.3	115.9	113.5	116.5	116.0	115.5	113.8	113.2	120.0	120.3

Source: Agricultural Institute of Slovenia (AIS)

Production of raw milk increased gradually over the period 1997-2002. In 2003, production declined and somehow stabilised after at around 655,000 tonnes. Despite of fluctuations in production, deliveries to dairies for processing had a constant upward trend resulting in an increase of the proportion of milk produced that is delivered to dairies from 66% in 1997 to 80% in 2007. However, all milk is not sold to domestic dairies. Since late 2004, when the

direct export of raw material has started, the share sold to foreign dairies has been on constant rise and has increased from 9% in 2005 to the level of 30% in 2008.

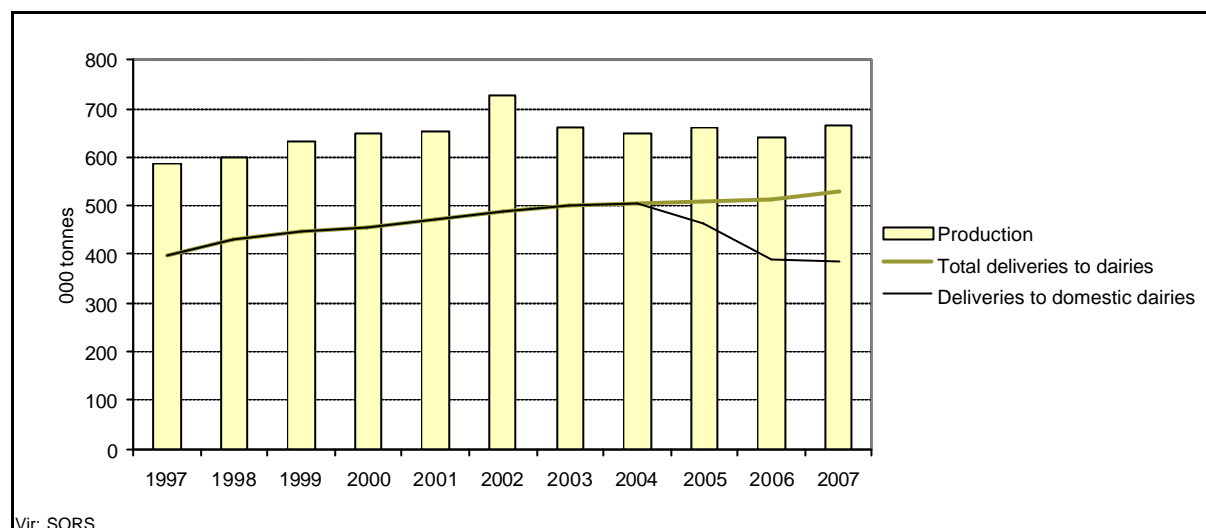


Figure 4. Cow's milk production and deliveries to dairies

The developments in quantities of milk purchased by domestic dairies are more or less reflected also in production developments in the main dairy products (table 8). The production of fresh milk and fermented products peaked in 2001 and the production of cheese, butter and cream in 2003/2004, when milk deliveries to domestic dairies was the highest. However, in the last years the production in dairies declined along with the decrease of purchase of milk.

Table 8. Trends in dairy production (in 000 tons)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Fresh consumption milk	:	:	:	166.2	179.7	172.1	159.0	178.8	178.8	156.2	164.5
Fermented dairy products	29.7	29.8	32.4	36.8	40.6	38.9	37.2	35.3	33.5	34.5	33.3
Cheese products	18.2	20.7	20.8	21.4	21.7	22.6	24.2	23.8	22.0	20.4	18.7
Cream	9.0	8.8	10.7	13.2	13.2	14.7	15.6	18.3	15.5	13.8	15.2
Butter	:	:	:	3.1	3.6	4.0	5.0	4.1	:	2.9	2.6

Source: SORS

Average consumption of main dairy products per capita has gone up since 1997, with the exception of fresh milk. Data on consumption in table 9 shows that the consumption of fermented products has increased to the level of around 18 kg per capita which is about 40% more than in 1997. The consumption of butter has increased by one third in the same period. The consumption of cheese increased even at a higher rate since the quantity grew by 57% in the period between 1997 and 2007 to 14 kg per capita.

Table 9. Consumption⁴ of main dairy products (in kg per capita p.a.)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Fresh consumption milk	53.3	53.5	53.8	57.3	61.1	61.9	61.7	61.2	63.4	51.3	54.2
Fermented dairy products	12.9	13.3	12.6	11.9	12.9	12.5	13.8	14.8	16.6	17.6	17.8
Cheese	8.9	9.6	10.0	10.0	9.9	10.3	10.8	11.4	12.2	13.0	14.0
Cream	4.1	4.2	5.2	6.3	6.3	7.2	7.7	8.4	7.3	6.9	7.8
Butter	0.9	0.9	1.2	0.9	1.0	1.1	1.0	1.1	1.2	1.2	1.2

Source: AIS

⁴ Only marketed dairy products included (without on farm consumption of milk).

Slovenia is traditionally a net exporter of dairy products. However, the increase in the consumption and the decline in production in recent years had considerably reduced the net export position of most dairy products (table 10). Exception is fresh dairy products where the net balance increased almost three times between 2004 and 2007, namely due to direct export of raw milk. On the other hand, Slovenia became an importer of cheese (and milk powder), after years of being a net exporter.

Table 10. Export and import of main dairy products (in 000 tons)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
EXPORT											
Butter	0.4	1.7	2.3	1.3	1.6	1.8	3.5	2.1	1.9	0.9	0.7
Cheese	2.0	2.8	3.4	3.4	4.0	3.9	6.2	5.1	4.7	3.4	2.9
Milk powder	0.9	0.5	1.6	2.1	1.0	1.1	2.0	4.3	1.7	1.1	0.3
Fresh dairy products	54.7	57.1	62.7	66.2	74.1	63.1	47.5	68.0	111.8	200.7	226.7
IMPORT											
Butter	0.0	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.3	0.5	0.6
Cheese	1.7	1.7	1.8	2.2	2.0	2.5	3.0	4.4	6.5	9.3	11.9
Milk powder	0.3	0.5	0.4	0.5	0.4	0.4	0.7	1.0	0.8	1.0	1.3
Fresh dairy products	1.8	1.9	1.5	1.0	1.7	1.7	2.5	5.9	22.3	62.5	51.6

Source: SORS

After accession to the EU, international trade with milk and dairy products has intensified significantly (table 11). The export value has increased year after year to reach 106 million euros in 2007 or twice as much as in 2003. However, in the same period the imports increased even more (five times) reaching 87 million euros in the same year, while trade surplus decreased from 31 million euros in 2003 to 20 million euros in 2007.

Within the analysed period one can observe also the change of the trading partners for dairy products. On the export side, the former Yugoslav markets were traditionally the main destination, which is a feature also for other product groups of processed food. However, after the Slovenian accession to the EU the proportion of sales to these markets has decreased significantly (from 77% in the period 1997-2003 to 21% in 2007), and the shares has been overtaken by the exports to the markets of EU-15 which in 2007 represented 78% of total export value. Evident growth of dairy exports value in the last four years is namely the result of direct exports of raw milk mainly to Italy. Beside Italy, Germany, Bosnia and Herzegovina, Croatia and Macedonia are the most important export markets for Slovenian dairy products.

On the import side the EU-15 has become an even more dominant supplier of dairy products, accounting for more than 80% of total import value up from 56% in 1997. The second place, with 13% of import value, is taken over by new EU member states, while the share of ex-Yugoslavia has fallen to 3% only from 30% in 1997. This is mainly due to opening of the market towards the EU after accession on the one hand and abolishment of preferential trade agreements with ex-Yugoslav countries on the other hand.

Imports of dairy products are primarily cheese and fermented products, although some imports of raw milk is also present. Most important sources of imports are Germany, Austria, Italy, Hungary (mainly raw milk) and Croatia.

Table 11. Trade totals, main destination of exports and main origin of imports (in EUR mill.)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
EXPORT											
Total agro-food (CN 01-24)	296.1	315.5	317.2	357.0	386.3	407.5	403.2	357.4	416.0	518.3	643.6
Of which Dairy (CN chapter 04)	30.2	34.4	37.1	42.2	51.0	47.6	48.6	51.4	65.3	86.6	106.3
EU 15	5.1	7.9	7.0	4.9	5.8	6.1	10.2	15.0	38.5	64.1	83.2
Of which Italy	4.3	4.4	3.5	3.3	3.8	3.3	2.8	9.3	31.7	58.2	74.7
Germany	0.2	1.7	1.0	1.1	1.6	1.2	1.8	3.1	2.8	1.9	3.1
EU 12	0.9	0.3	0.3	0.1	0.3	0.3	4.4	4.3	2.8	1.1	1.0
Ex-Yugoslavia	22.9	24.6	27.8	35.5	42.7	39.6	31.7	30.3	23.1	21.2	21.9
Of which Bosnia and Herzegovina	8.6	8.0	13.3	17.6	22.4	21.5	15.1	13.6	10.7	8.6	8.2
Croatia	11.7	13.1	10.5	9.8	11.6	9.1	7.9	7.7	4.5	5.1	5.8
FYR Macedonia	2.6	3.3	3.6	3.7	2.6	2.8	2.8	3.8	2.9	1.8	1.4
Other countries	1.3	1.6	2.1	1.8	2.2	1.6	2.4	1.9	0.9	0.3	0.1
IMPORT											
Total agro-food (CN 01-24)	661.6	660.8	644.7	700.2	747.4	759.1	772.9	888.5	1022.8	1180.0	1460.9
Of which Dairy (CN chapter 04)	11.0	11.7	11.4	12.7	13.2	15.1	17.4	26.3	46.3	69.5	86.6
EU 15	6.2	6.9	7.0	7.9	8.3	10.8	13.2	22.5	39.0	51.4	73.0
Of which Germany	2.6	2.9	2.9	4.0	3.9	4.7	5.2	10.9	18.9	23.7	29.2
Austria	0.7	1.0	1.4	1.0	1.7	2.3	4.4	6.1	9.4	15.3	24.1
Italy	1.8	2.0	1.7	1.5	1.6	2.1	1.8	3.3	6.8	8.9	11.8
EU 12	0.3	0.3	0.1	0.1	0.4	0.2	0.4	1.7	5.4	15.3	11.1
Of which Hungary	0.0	0.0	0.0	0.0	0.3	0.1	0.1	0.7	3.0	11.6	9.1
Ex-Yugoslavia	3.3	3.7	3.5	3.9	4.1	3.6	3.6	2.2	1.9	2.7	2.4
Of which Croatia	3.3	3.6	3.4	3.6	3.9	3.5	3.6	2.1	1.9	2.7	2.4
Other countries	1.2	0.8	0.8	0.9	0.4	0.4	0.1	0.0	0.0	0.1	0.1

Source: SORS

2.4 Government policy

2.4.1 Regulatory framework of the dairy sector

Dairy market policy

Given the important role of dairy production in Slovenian agriculture, the dairy market has always received a lot of attention in agricultural policy considerations. For more than a decade prior to EU Accession, high import tariffs for milk products (comparable with levels in the EU at that period) alongside substantial export support were the main pillars in the economics of the dairy sector. Up to the 2001 farm-gate price for raw milk was fixed by the government and until 1998 fixing of the milk price at the farm-gate level was supplemented by a control on the retail price of standard pasteurised milk (maximum price was set by the government). After abolishing of fixed milk prices in 2001 CAP-like market organisation was introduced, but without restrictions (quotas) on production. The border protection and export supports have remained relatively high. This policy ensured rather favourable income for farmers as well as for dairy industry.

For milk producers, another important agricultural policy measure with direct income effect was support to areas with less favourable conditions for agricultural. Since 2000, compensation of higher production costs due to unfavourable natural conditions has been granted per hectare of utilised agricultural area on principles consistent with EU. Milk producers also benefited from general programmes for input compensation, investment support, and agro-environmental assistance.

Although Slovenia started to introduce CAP-like market regulation in the dairy sector in early 2000s, EU accession brought quite a substantial change in this field both for dairy producers and processors. For milk producers, these changes are reflected mainly in the introduction of the milk quota system and direct income support and for dairy industry in opening of the market towards EU members and changes of trade regimes with third countries.

The quota system, which has been fully implemented in Slovenia as from the milk year 2005/06, has generally not implied serious production restrictions since the quotas have not been fully met. Increased competition and price pressures after accession were largely compensated by the introduction of milk premiums. In Slovenia, dairy premiums have been implemented in the same way as in the old member states (per kg of quota). In the quota year 2004/2005 milk premiums, together with national top-ups reached 85% of the full amount applied in the EU-15 Member States, in 2005/2006 90% and in 2006/2007 95% of that amount.

As from 2007, with the implementation of CAP reform, a new direct payments scheme was introduced. The reform introduces a basic flat rate payment per hectare throughout the country as the main type of direct payment in agriculture (332 EUR/ha for arable land and 108.7 EUR/ha for permanent grassland). Beside that, the producers in the milk sector are eligible for an additional specific supplement based on farm historical entitlements, where 80% of the full amount of dairy premiums (100% of the EU-15 level) for individual quota held on 31 March 2007 was included.

Since 2005 support under CAP direct payment scheme has been subject to cross compliance requirements. Compliance conditions for receiving payments have been applied gradually over the 2005-2007 period starting with 5 environmental standards and 3 standards for animal identification and registration. Among others, farmers must comply with the requirements set in the Nitrate Directive targeted to protect waters against pollution from agricultural sources. National legislation in this regard has been adopted already in 2001, setting the limit on the annual amount of organic nitrogen used on agricultural holdings to 170 kg/ha and establishing *Nitrate Vulnerable Zones* covering the entire territory of Slovenia. Since stocking density at farms is generally relatively low the compliance with this restriction has not imposed serious reduction to the number of animals. However, it could be considered as a limiting factor for further consolidation of the sector.

To meet other Nitrate Directive requirements and principles of good agricultural practice set by cross compliance comprehensive funds were granted in the framework of transitional support measure for meeting EU standards which formed part of the Rural Development Programme 2004-2006. Slovenia used this measure mainly for setting up the situation on agricultural holdings regarding the manure storage facilities. Though, in the years 2005-2007 investment support for the construction and adjustment of manure storage facilities for 123,600 livestock units, representing nearly 30% of the total livestock in Slovenia, was granted.

Beside support for meeting EU standards, Rural Development Programme 2004-2006 introduced also a support for early retirement and took over the measures for less favoured areas (LFA) and agri-environmental measures, which were harmonised with the EU principles through the reform process already in the pre-accession period (1998-2002) and did not change much after EU accession.

The agricultural structural policy measures, which were in the pre-Accession period implemented under SAPARD programme and under the national part of the structural policy programme, have largely continued under the Single Programming Document 2004-2006. The majority of funding was intended for improving processing and marketing of agricultural products, investments in agricultural holdings and diversification of agricultural activities. New Rural Development Programme for the period 2007-2013 is more or less continuing this policy.

Support for investments on farms and in processing industry, as well as LFA and some agro-environmental payments were and still are an important element of economic performances of dairy sector.

Food safety

Despite the fact, that Slovenia has traditionally had high level of food safety and quality regulation and proved efficiency, pre-accession harmonisation of the legislation in this area has brought some further improvements. The activities in this respect began in the middle of 1990s with the harmonisation of the quality schemes for raw milk at the farm level, later followed by the full implementation of the EU hygiene and sanitary standards in the dairies. The Slovenian government was relatively strict with implementation of these standards. A general believe among food entrepreneurs is that food safety regulation is implemented more strictly in Slovenia than in some other EU member states, and therefore that such administrative burdens reduce competitiveness.

Food quality schemes – protection and promotion of specialty agricultural and food products

With respect to the regulatory framework of the dairy sector also the policy of food quality schemes should be mentioned. Slovenia has adopted the EU system with specific quality schemes being introduced to develop geographical indications, organic farming, and traditional specialities. In Slovenia four dairy products have passed procedures and are awarded “Protected designation of origin” (PDO) at the national level, however none of them has been registered at the European level yet. Tolminski cheese is a typical Slovenian type of cheese, very similar to the Montasio cheese produced in the Friuli region of Italy. It is produced in Kobarid and surrounding mountains of north Primorska region. Nanoski cheese is gaining importance on the Slovenian market too. It is widely distributed and placed within the specialty fridge cabinets. Bovški cheese is produced from two to three types of milk, but sheep milk is the dominant ingredient with some goat and cow milk. It is available only on farms. Similarly there is no market production of the Mohant cheese.

The specialty agro-food products are a segment still under development, since the production is rather unstable (with some exemptions e.g. Nanoski and Tolminski cheese!), promotion is insufficient and therefore producers are not able to secure a premium price for their additional efforts.

2.4.2 Other dairy sector relevant policy areas

There are no specificities in general policy framework related to dairy industry. Relatively recently Integrated Pollution Prevention and Control (IPPC) system has been employed to

control the environmental impact to air, land and water of emissions arising from industrial activities. It involves determining the appropriate controls for industry to protect the environment through a single permitting process. The dairy industry is regulated by IPPC under section 6.8 "The Treatment of Animal and Vegetable Matter and Food Industries". All companies operating in food industry were required to have applied for their IPPC permit by 31 September 2005, and the Environmental Agency of the Republic of Slovenia has issued permission after the processing the applications.

3 Performance of the dairy supply chain

3.1 Performance at farm level

3.1.1 Yields

Over the last few years, milk production at the primary level has undergone intensive specialisation and consolidation. While in 1997 a solid half of all agricultural holdings (51%) were engaged in dairy production, this share slumped to a mere 25% by 2007. Hand in hand with specialisation there has been a change in the breed structure of herds with the proportion of specialist milk breeds increasing and that of combined purpose breeds (for milk and meat) falling. This, together with technological advances in breeding and nutrition, has led to higher average milk yields and improved quality of purchased milk. During one decade (1997-2007) the milk yield has increased by more than 50%.

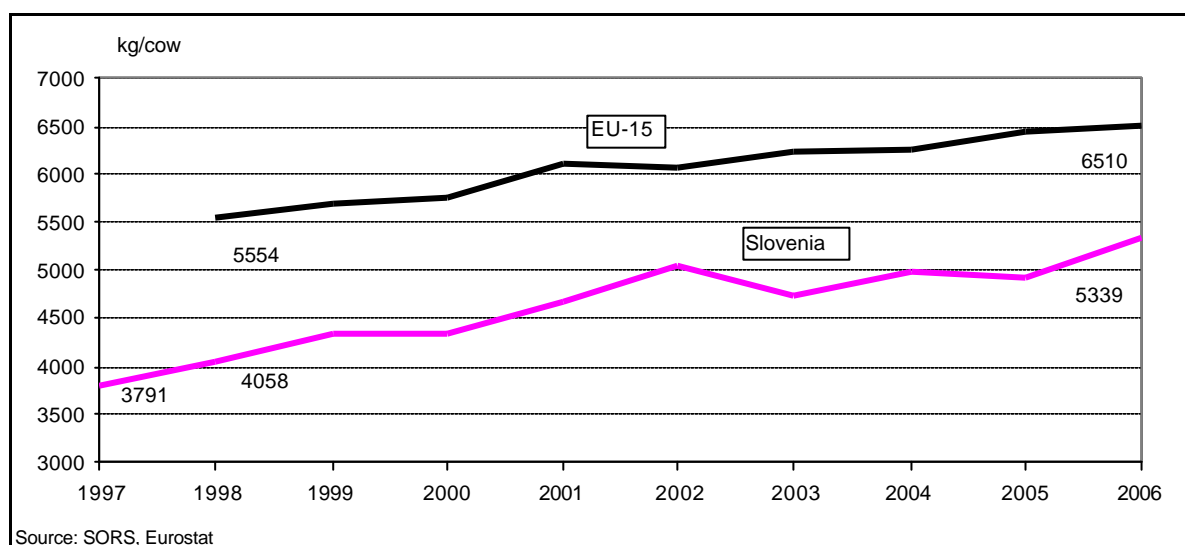


Figure 5. Developments in milk yields per cow p.a. in Slovenia and EU-15; 1997-2006

Comparing the milk yields with the EU average one can still realise rather low technical efficiency of Slovenian dairy farming. The average milk yield per cow in Slovenia is below the averages achieved in the EU. At 5,340 kilograms per cow p.a. in 2006 the Slovenian average yield was at around 82% of the EU-15 average and at 90% of the EU-27 average (5,950 kg). Similar relations are noticed also if Slovenian milk yields are compared with Austria, Italy and Hungary, with which Slovene producers have to compete.

Part of the explanation of Slovenian average yields being on the lower end of the range in the EU may be in still low share of Holstein-Friesian cows in dairy herds (31% in 2007) and in large share of dairy farms in the less favoured areas where forage production is limited mostly

to grasslands. Around 47% of the Slovenian dairy cow herd is Simmental type and another 16% is Brown Swiss. These cows are more suitable for combined milk and beef meat production which dominate on the smaller farms and in the less favoured, hilly areas. The yield registered at farms included in the milk control programme which covers about 80% of all dairy cows in Slovenia is higher (6,500 kg in 2006) and comparable with the EU average.

As far as the quality of raw milk is concerned, in the last years on average about 92% of purchased milk is classified in extra quality and additional 6% in first quality grade.

3.1.2 Prices

Until 2002, milk prices in Slovenia had an upward trend (in euro terms) as a result of the governmental policy to support the dairy sector by price and trade policy (figure 6). In early 2000s milk prices to farmers came under pressure which resulted in its gradual decrease almost back to the level of 1997s. Gradual stiffening of conditions in the market even before EU Accession could be largely attributed to the changes in governmental policy in 2001 and related abolition of producer price fixing (see 2.4.1), but also to the changed balance of power in the dairy chain. Due to consolidation in the retail sector, dairies had to economize their business and one way to do that was to lower the prices paid for the raw milk to farmers.

After accession and adoption of the EU common market organisation, the introduction of dairy premiums was used by the industry to justify further cutting of milk producers' prices. As a result, some mainly large co-operatives signed contracts to sell milk directly to Italian dairies at higher prices than those obtainable in Slovenia. In 2006 milk prices started to recover again. The rise was considerable especially in the second half of the year 2007, when favourable conditions for dairy products on international markets pushed producer prices up all over the EU.

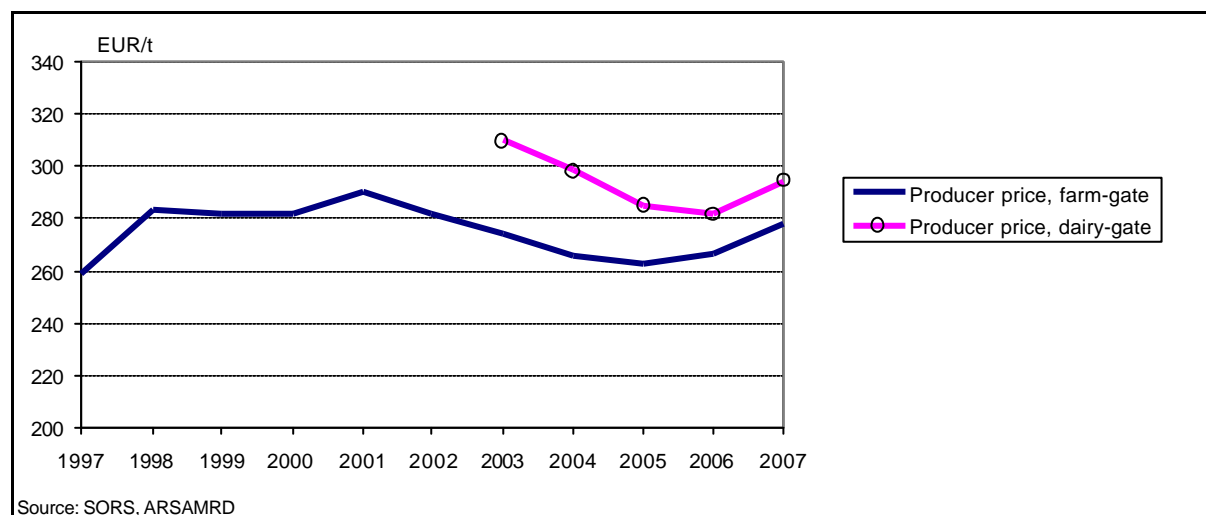


Figure 6. Milk price developments; 1997-2007

Figure 6 also shows the difference between the prices paid by the dairies and the prices received by the farmers. This difference is rather high partly due to relatively widespread network of milk routes and milk collecting centres and partly due to relatively high commission fee for administrative services related to milk collection, charged by intermediate between farmers and dairy (mostly cooperatives). However, in last years a significant

reduction of collecting costs has been noticed, from over 10% of the dairy-gate price in 2003 to about 5% in 2007.

In last years, the farm gate price of milk in Slovenia was lower than in most EU countries and significantly lower than in Italy (figure 7)⁵. Generally, Slovenian milk prices follow the trend in the EU, but at the lower pace.

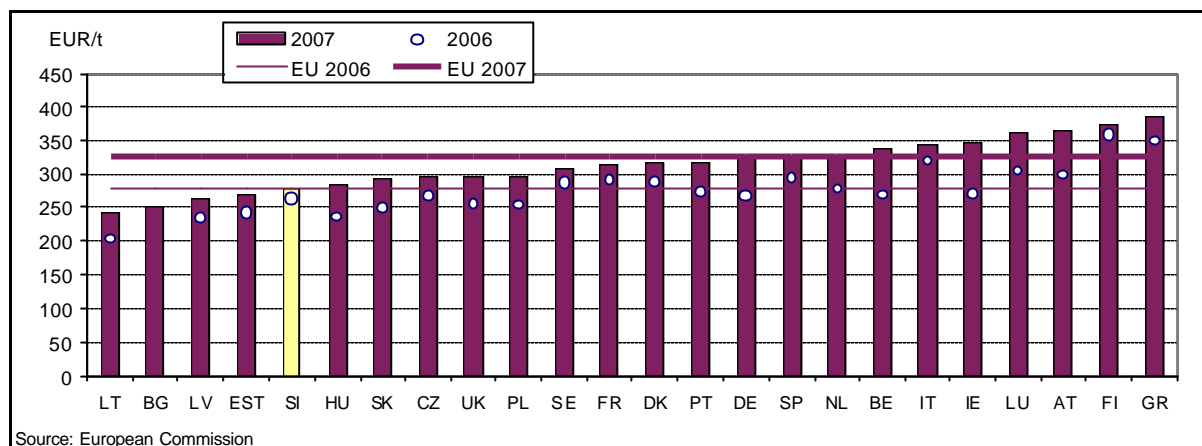


Figure 7. Milk prices in the EU

3.1.3 Gross margins

The question of whether an enterprise is capable of producing a positive margin is an important element of competitiveness. Table 12 sets out an estimation of gross margin on an average Slovenian dairy farm⁶. It provides a basic listing of the key production variables and the associated revenues and direct costs. It indicates that with an average yield of 5,770 kg/cow and milk price of 29.13 euro/100 kg (2007 average), the farms achieve:

- a gross margin (total income less variable costs) of 17,081 euros
- a gross margin of 26.56 euros per 100 kg of milk;
- a gross margin rate of return on revenues of 67% (26.56 / 39.35);
- and a gross margin rate of return on milk sale of 91% (26.56 / 29.13).

Gross margins are difficult to compare among countries due to different methods used for calculation on the one hand (with or without subsidies and turnover from calf sales, specific variable costs only or total variable costs together with costs related to the production of animal feed etc.) and different production characteristics and agricultural policy support measures on the other hand (different levels of production technologies, yields, different level of support, different levels of dependence on purchased inputs, etc). However, the fact that Slovenian producers increased the production in the frame of relatively low milk prices and export significant quantities of milk to Italy shows that the production is relatively competitive at least in regional context.

⁵ European Commission database provided by Ministry for agriculture, forestry and food

⁶ Gross margin is calculated on the bases of simulation model developed by the Agricultural Institute of Slovenia and used for estimation of production costs of individual agricultural products.

Table 12. Estimated gross margin on average Slovenian dairy farm; 2007

Number of cows	12
Yield (kg/cow)	5,770
of which sales (kg/cow)	5,360
UAA (ha)	14
of which fodder area (ha)	9.3
Values in €per 100 kg milk	
Total revenues	39.35
- Milk and dairy products	29.13
- Direct payments	4.91
- Turnover (calf sales)	5.31
Total calculated direct costs	12.79
- Feed concentrates	4.20
- Health care and insemination	1.15
- Energy	1.68
- Fertilizers	1.45
- Seeds and crop protection	0.51
- Insurance	1.34
- Other costs	2.46
Gross margin per 100 kg of milk	26.56
Gross margin rate (of return on milk sale)	67%
Gross margin (total revenues less variable costs) in €per farm	17,081

3.2 Performance at industry level

3.2.1 Turnover and employment in the dairy industry

The milk processing industry has traditionally been among the leading food sectors in Slovenia in terms of business performance and also in terms of technological progress. The quality requirements and hygiene standards were always high. There has been no closing of processing plants as a result of EU requirements, but enterprises have invested a substantial amount of capital to harmonise the sanitary procedures with *acquis communautaire* during the pre-Accession period.

The sector structure has also been improved since the end of the 1990s and beginning of the new millennium. Now it is dominated by three dairy companies, which are still, however rather small in comparison with foreign competitors. Consolidation has initiated some restructuring activities in terms of optimisation product range and plant specialisation, but the competitiveness of this industry in Slovenia is currently still rather weak. This is mainly due to a pre-Accession dairy policy which with high import duties and export support protected Slovenian processors from international competition. After EU Accession, high tariff barriers for dairy products were removed and imports increased toughening the economic conditions for the dairy industry.

Total sales of the Slovenian dairy industry were at about 260 millions EUR in 2007, which is about 2% more than in the previous year in real terms, but when the figure is compared to the year 2003 the turnover is lower by around one quarter (table 13). Business performance of the

sector deteriorated significantly, mainly due to the changes in the economic environment, but also due to changes in export subsidies system after the accession to the European Union. Transfers of export subsidies to the sector have been reduced by some 70% in 2004 with further cut downs in the following years, since the companies were poorly successful in acquiring export subsidies under the EU harmonised system which gives the export subsidies for different products and destinations than it was the case in Slovenia before the accession: the export subsidies in EU are not granted for the exports to the Western Balkan countries the main export markets of Slovenian dairy industry.

After a considerable fall of direct exports in 2006 in the last year they rebounded again to the figures comparable to pre-accession real values. Still, the biggest part of the sales is realised at the domestic market, since the export sales in total sales represents 20% in 2007. This is at the average export orientation value by the Slovenian food industry sector.

Table 13. Basic business indicators of the dairy industry (in real terms)

Indicator	2003	2004	2005	2006	2007
Number of enterprises	23	24	22	23	22
Average number of employees	1,705	1,663	1,473	1,323	1,254
Turnover (<i>mill. EUR</i>)	280.83	271.31	252.50	245.63	259.87
Direct exports (<i>mill. EUR</i>)	44.43	48.32	49.76	41.75	52.17
Shared capital (<i>mill. EUR</i>)	181.63	188.99	199.27	190.40	185.48
Turnover per enterprise (<i>mill. EUR</i>)	12.21	11.30	11.48	10.68	11.81
Turnover per employee (<i>EUR</i>)	164,711	163,134	171,418	185,617	207,150

Source: AJPES - Agency of the Republic of Slovenia for Public Legal Records and Related Services

One of the important features of the period is radical reduction of employees in the sector, since the figure in 2007 is 26% lower than in 2003. This has resulted in notable growth of productivity, and on average an employee in Slovenian dairy enterprise realises around 207 thousand EUR of turnover annually. This productivity level equals roughly 30% of the EU-15 average and higher productivity was also recorded in neighbouring Austria and Italy.

Changes in average turnover per enterprise in the sector have not been positive, since in real terms the value in 2007 is lower than in 2003. This is to a large extent the effect of inactive enterprises still registered in the sector but with no actual turnover.

In the last three years also the ratio of the cost of goods, material and services to net sales has deteriorated showing upward corrections of raw milk prices and higher energy costs. However, also the downward pressures on prices of final products affected the ratio since the market competition intensified significantly after the Slovenia entered the European Union in 2004.

3.2.2 Value added and profits

Figures on value added and profitability in the Slovenian milk processing companies show important deterioration in the period, however with a slight positive move in 2007 (table 14). This decline was partly caused by the drop in export subsidies; however, even if subsidies are excluded from the calculation the value added and profitability is lower than in pre-accession period. The dairy sector has been among the most profitable over many years, but the period of high trade protectionism and export subsidies came to an end and pushed the sector into intensive restructuring.

Table 14. Basic business performance indicators of the dairy industry (in real terms)

Indicator	2003	2004	2005	2006	2007
Gross Added Value at factors cost (<i>mill. EUR</i>)	44.2	31.2	34.3	23.2	36.8
EBIT - earnings before interests and taxes (<i>mill. EUR</i>)	2.78	-9.14	-7.32	-14.08	0.03
Operation gross surplus (<i>mill. EUR</i>)	4.28	-9.71	-8.63	-13.04	-2.15
Gross Added Value per employee (<i>EUR</i>)	25,924	18,760	23,286	17,532	29,335
Operational gross surplus per employee (<i>EUR</i>)	2,511	-5,836	-5,857	-9,851	-1,710

Source: AJPES - Agency of the Republic of Slovenia for Public Legal Records and Related Services

The GVA per employee in the dairy sector in 2007 is about one tenth lower than the average for all food industry sectors. If compared to the manufacturing industry as a whole the difference is around 6%. Yet, the dairy industry has lost much of its strong position it had before, when the results were about one tenth above the food industry average. Comparison of this indicator of the Slovenian dairy industry with the EU-15 competitors shows that 2003 GVA/employee in the Slovenian dairy sector only reaches 56% of the average EU-25 level. In many European countries GVA per employee in the dairy industry is much higher, range to 67,800 euro in Austria and 81,100 euros in Ireland (Eurostat, 2006).

Profitability of Slovenian dairy industry has decreased radically after accession, as net losses almost doubled in 2004 from the year before and the similar increase happened in 2006, when the sector reported 13 million euros of net losses. Last financial year the sector closed with only around one fifth of net loss from previous year, but the earnings before interests and taxes (EBIT) were positive only at subsistence level, showing that loss is likely due to expenditures for interests. Of the 22 companies in this industry, ten reported losses in 2007 (45%).

3.2.3 Market share developments

Data on import and consumption of main dairy products indicate that the Slovenian dairies are losing market shares on domestic market to foreign competitors. This tendency started already in 2000 but has intensified after accession to the EU.

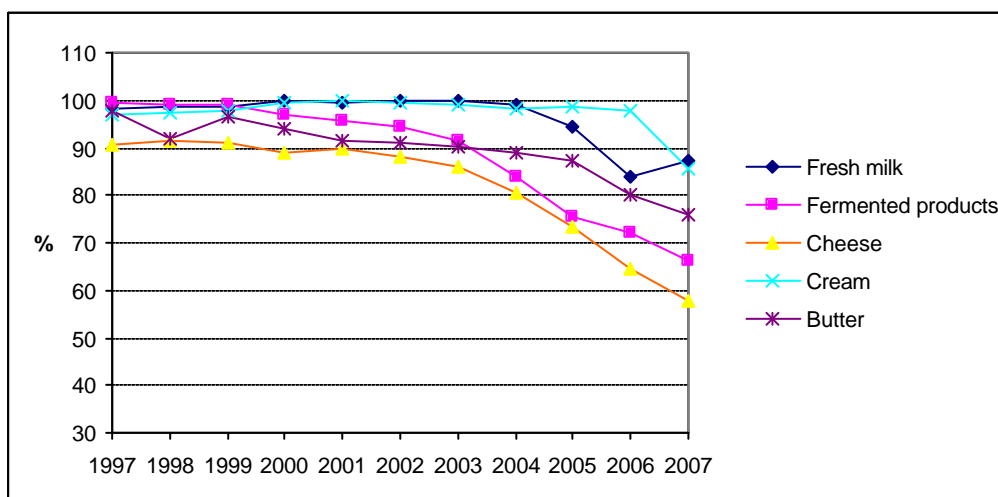


Figure 8. Share of Slovenian dairy sales⁷ in the total domestic consumption of main dairy products; 1997-2007

⁷ Slovenian dairies sales are calculated as a difference between consumption and imported quantities of individual dairy product.

The biggest decrease in market share is evident for cheese (from 86% in 2003 to 58% in 2007) and fermented dairy products (from 90% in 2003 to 66% in 2007). For fresh milk and cream, where until 2003 nearly all domestic consumption was from produce sold by Slovenian dairies, the market shares declined below 90% by 2007.

For fresh milk and cream a decline in domestic market shares has been somehow compensated by an increase in shares of export (figure 9). Export market share in total domestic fresh milk production has increased from about 30% in the period 1997-2005 to more than 40% in last two years. After 2005, some positive development is evident also for fermented products, while for cheese and especially for butter the export market shares of Slovenian dairies are still on the decline.

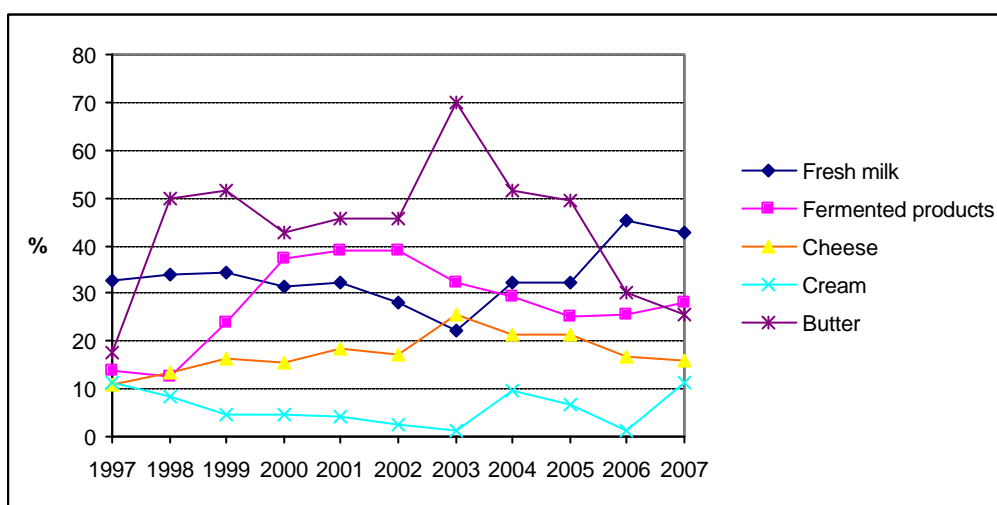


Figure 9. Share of Slovenian dairy exports in the total domestic production of main dairy products; 1997-2007

3.2.4 Competitiveness at retail level

Retailing industry having an increasing market power is a global phenomenon clearly present also in Slovenia. The level of concentration in the retailing sector is among the highest in Europe. The process of retail consolidation and restructuring has been reflected most obviously in the pressures on purchase prices and contracting conditions, shifting of an increasing share of transaction and distribution costs to suppliers. The strategy of cutting cost by the retailers reflects in their effort to decrease the number of suppliers for one group of products. Having in mind the market power of retailers this eventually resulted in excluding most of small suppliers with no brand/not specific products and elimination of less profitable products from store shelves.

Important strategy of all major retailers is the introduction of private labels. They are present in most of the product groups, however retailers have started to introduce this brand category into the dairy segment among the last. Market share increased with the similar trend as for other food product groups, and the expected share in the future is around one third of total sales. The strategy used by food retail companies when introducing their private label brands took advantage of the unelaborated strategy of producers – it prevents differentiation between producer's brand and private label brand and often there were in fact no difference between

the two. These products have to be the cheapest and are known for their low margins (both to retailer and to producer).

On the other hand, the selection of products is rather wide and national brand are dominating virtually all categories, alongside with retailer labelled goods still predominantly produced by Slovenian suppliers. Still in eyes of consumers it is perceived, that the quality of Slovenian products is rated higher or similar to foreign brands.

The profound changes that have taken place in Slovenian food retailing have offered considerable economic advantages to operators. Also heavy investment has allowed retailers to reap economies of scale through the operation of large store formats and large chains of stores. This has been supported by the implementation of sophisticated logistics and distribution systems married with significant investment in new technology (such as e-POS). The result has been significantly improved efficiency with greater sales per outlet and per employee. However, beside a very successful modernisation, introduction of contemporary management practices and conduct, established growth of profit might be ascribed to the market structure too. Bilateral oligopoly market structure enables economic domination of retailers in the Slovenian food chain. High level of vertical power makes retailers possible to introduce business practices that adversely affect the competitiveness of their suppliers and distort competition.

Beside the evident negative effects on food suppliers' business performance the result in Slovenia might be also that dairy processors and other food suppliers are likely to invest less and spend less on new product development and innovation, leading to lower quality and less consumer choice.

4 SWOT

4.1 Strengths and Weaknesses

The domestic farm level production is actual showing more strengths than weaknesses in comparison with the processing level which is suffering a lot through the opening of the markets after EU accession and increasing market power of the retailing sector.

Table 10. Strengths and Weaknesses of the Slovenian dairy sector

STAGE	STRENGTHS	WEAKNESSES
Farm Level	a) High quality of milk	a) Small scale structure of farms and high share of production located in LFAs resulting in low labour productivity
	b) Price competitiveness (producer prices below EU averages)	b) Low level of specialisation (high share of mixed breeds for milk and meat production with lower milk yields)
	c) High market orientation	c) High costs of milk collecting and administration
	d) High expertise levels and existing network of farm extension service	d) Still low average gross margins (but high differences between the farms)
	e) Relatively high genetic potential for milk production of significant part of the national herd	e) Specialised dairy farms are in minority, combined dairy and meat production still prevails.
	f) Good natural conditions (grassland) for sustainable production	
Processing level	a) Strong supply base (well developed milk collection service)	a) High costs of milk collection (small-scale producers, well spread geographically).
	b) Lower milk costs (below EU average)	b) Structural deficits (scale and scope inefficiencies) and hence low productivity and international competitiveness.
	c) Relatively high quality of dairy products	c) Insufficient market orientation - lack of new product development, brand management and promotion
	d) Consumers loyalty to domestic products	d) Inability to cope vertical domination by the highly concentrated domestic retailers
Retail level	a) Good range of products, domestic products prevails	a) Strong dependence on domestic market with rather small potential for international expansion
	b) Good standards of service	b) Comparatively small enterprises
	a) High level of market concentration	c) Relatively good business performance based on market imperfections

4.2 Opportunities and Threats

The key element of the future development in the Slovenian dairy sector is the competitiveness of the processing sector. Dairy farms can be a stable supplier of the raw milk more or less in any market condition, while dairy industry at the processing level needs significant improvement in scale, market performance and development of new products. FDI in this sector could be seen more as threat than an opportunity due to small scale, demand for raw milk and relatively competitive dairy structure in the region.

Table 10. Opportunities and Threats of the Slovenian dairy sector

STAGE	OPPORTUNITIES	THREATS
Farm level	a) Farm restructuring and further increase of production	a) Milk quota abolishment could increase the pressures on milk prices
	b) Further increase of quality schemes (GIs or organic production)	b) Non-competitive dairies could be closed down and the milk suppliers not taken over by other dairies
	c) Further technological developments	c) Feed grains price situation could worsen the economic performance of the sector
		d) Climate changes effects with more draughts
Processing level	a) Growth of consumer demand for products where dairies show competitive advantage (fresh dairy products, sterile products) and market expansion on foreign markets	a) Further import penetration and decrease in market shares
	b) Increase quality and efficiency of production through investments co-financed from existing public funds	b) Further pressures on prices and contracting conditions from retail sector
	c) Further strengthening of food ethnocentrism in Slovenia (growth of loyalty to national producers and brands) and demand for products with denominations (PDO, PGI, organic products)	c) Not sufficient funds for marketing to compete with the multinational brands coming on the market
		d) Foreign capital takeover and processing capacity reduction or facility closure.

5 Suggestions for policy recommendations

The Slovenian dairy food chain is faced with some important challenges. They stem largely from the changing economic environment, foreign competition and weak domestic competitiveness at the processing level. EU Accession and further changes to the CAP (liberalisation of the market, factual abolishment of export refunds, introduction of decoupled payments) have reduced the levels of market protection, which crucially contributed to the stability and attractiveness of the dairy sector in the past. The pressures arising from reduced supports have been felt more in the processing industry, which is faced with tighter competition on the domestic market thus forcing producers to increase exports. However, a large part of dairy processing industry has still to achieve the required competitiveness in terms of prices or quantities.

On the other hand, raw milk producers have been in a somewhat more favourable position thanks to the relatively high quality of raw material and the nearness of the Italian market, where there has been good demand for this product at relatively favourable prices. However,

even they face problems of poor competitiveness, due mostly to small volumes of production per farm and high costs of milk collecting.

The entire chain faces further structural change, which will result in increased production on larger farms, movement of production away from more distant areas, consolidation in the milk processing industry and in various measures aimed at reducing production costs such as lowering of labour costs and focusing on a narrower range of the economically most attractive products. All these trends have already begun and are expected to intensify in the future.

It is clear that the main challenges for the future of the Slovenian dairy sector are coming from market and not from policy side. The policy is created on the EU level and the Slovenian voice in the Council is relatively weak. The producer organisations at the farm level are full of fears due to expected dairy quota abolishment after 2015. The effects of quota abolishment are difficult to predict. However, it is clear that competitiveness of the whole dairy chain is the key factor which enable the opportunities to prevail against the threats. The dairy processing industry is complaining about the strong market power of the retailers, not doing enough for straightening of its own position on the market. The main task of the government should be to support development and competitiveness of the sector instead of protecting it. In the frame of existing and future CAP (after “health check” CAP changes) policy measures should be focused on following elements:

- increase of targeted investment support on the farm and processing levels;
- use the opportunity for specific actions in the direct payments scheme for mitigating the dairy quota abolishment effects (support for milk collecting in the LFA areas);
- more efficient competition policy instrument to limit market powers of retailers;
- more support for technological progress at the farm level with better extension system and development of new technologies adopted to the new economic and climate conditions;
- more support for research and development activities for the processing sector regarding development of new products, functional food, products with geographical indication (PDO, PGI) and organic trade marks.