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STRUCTURE AND COMPETITIVENESS OF THE MILK AND DAIRY SUPPLY CHAIN IN CZECH REPUBLIC

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CONTENT

1 Introduction to the dairy sector

Production of milk accounts for more than one third of the value of animal production and its´ share of the value of the gross agricultural production is around 17 %. There was a clear trend in milk production in the Czech Republic before May 2004. From the end of the 1990s a more or less stable volume of milk, of around 2700 mil litres a year, was produced as a continuous decline in the dairy herd compensated for an increase in the average yield.

Opening up the market brought a new dynamic to producers´ behaviour and to the development of the basic parameters of milk production. While, in the period before EU enlargement, foreign trade in the dairy sector in the Czech Republic was represented by trade in milk products almost entirely, EU enlargement has created a market in raw milk in Central and Eastern Europe. Exports of raw milk from the Czech Republic represent an important part of dairy production.

Demand from processors abroad together with demand in the domestic market has increased the domestic price and encouraged a greater volume of milk production. The long-term declining trend in dairy cow herd size changed with a slight increase in 2005. The average number of dairy cows in the Czech Republic was 437 900 head in 2005, with an average yield of 6254 litres.

Total production of milk increased in 2005 by 5.2 % compared to 2004 and was 2738.8 mil litres however exports of raw milk meant that less was available for domestic processors than in previous years and milk imports did not cover the loss of raw milk on the domestic market.

The direct payment budget given from Brussels transferred into an acreage payment was 2110.4 CZK/ha (70.86 €) in 2005. Support for milk producers is supplemented by a top-up payment of 2 006.6 CZK/livestock unit (67.37 €) in 2005 Also foreign trade in milk products in the Czech Republic has exhibited significant dynamics after EU enlargement. Within two years exports of milk products expressed in milk equivalent had increased by 8 % and imports had increased by 90 %. The positive balance decreased from 2003 to 2005 by almost 40 %. In 2005, the share of exports of milk products (expressed in milk equivalent) in total milk utilisation was 33.6 %, the share of imports 21.6 %.

From the territorial point of view, a considerable shift occurred in Czech trade in milk products with EU countries in 2004 and 2005. While in 2003 the share of export value from the Czech Republic to the EU-25 countries was 46 % of the total value of Czech exports, in 2005 this share had increased to 66 %. Imports from the EU-25 countries accounted for 96% of the total value of imported milk products in 2003 and 99 % in 2005.

2 A dual sector

Semi-subsistence dairy farms do not have an important position in the milk sector in the Czech Republic. Their importance can be documented by the data of milking control. In 2004 together 97.5 % of dairy cows in the Czech Republic were included to the milking control made by the Czech-Moravian Union of Breeders. Only 0.1 % of dairy cows in this control were in herds with 1- 10 cows.

3 Prospects for dairy product consumption

Human consumption of milk and milk products expressed in milk equivalent has shown a persistent increasing trend. Within last 8 years the annual consumption of milk and milk products (excluding butter) per capita rose by about 22 %. In 2004 the average consumption reached 230 kg/head. In this year 61.6 kg per capita of liquid milk was consumed, 12.0 kg cheese (without curds), 3.6 kg curds and 32 kg other milk-based products. The greatest increase was exhibited by the consumption of cheese, especially fresh cheese. A jump in 2000 (in connection with BSE) was continuously followed by significant increases in the following years, moreso after EU Accession due to the variety of cheeses available from other EU-25 countries and a fall in the domestic price. The rising per capita consumption of milk and milk products as well as consumption of cheese is expected to continue.

The increase in human consumption of milk products has appeared most in high value added products – cheese. Also the consumption of butter has increased significantly. After a comparison of consumption development and price change we can state, that there is no direct relation between these two indicators. However the significant factors seem to have been price stabilisation post 2000 couples with rising incomes 0and changing tastes.

4 Expert views on the challenges at the level of the milk production

Substantial investment in technical equipment and in modern forms of stabling in recent years have resulted in the contemporary situation where more than 60 % of the dairy population is housed in facilities with modern technical equipment. Hygiene and quality of raw milk is of a high standard. In 2005 98.7 % of milk delivered to dairy plants was of 1st standard or extra quality. Both the milking and storage infrastructure have been modernised.

One of the key points of issue for milk producers became the EU quota system. In the past two years it has represented a restrictive measure for a lot of producers. Market share of milk produced is at the highest level. In 2005 95.4% of milk production was sent for processing in dairy plants. In the quota year 2004/05, deliveries of milk for further processing amounted to 99.22% of the national reference quantity, while in quota year 2005/06 supply was 2,697,768.5 tonnes, which represents an overshoot of 0.62, the national reference quantity for deliveries being 2,678,931.9 tonnes.

Another point of issue seems to be the expected price development in the near future. After a rapid increase in the farmgate price of milk in 2004 and at the beginning of 2005, a continuous decline followed. The average producer price of milk in the first five months of 2006 was almost 5 % lower than in the same period in 2005 and under CAP reform further decline is expected. In spite of the proposed further milk price decrease, the volume of milk production in the Czech Republic in near future is forecast to follow the upper band of the national reference quantity.

Another point of issue is the amount of labour used in milk production in the Czech Republic. The share is relatively high in comparison to the EU-15 countries. Modern technical equipment is used by some agricultural enterprises only, while the smaller, but still important part of the sector need investments in this area. Wage costs are predicted to rise, but those enterprises yet to be modernised lack the financial resources for investing in modern technical equipment.

5 Expert views on the challenges at the stage of milk collection from farms

Milk collection is organised by particular processing plants for their own needs. Currently an every day collection prevails, however the number of producers with the equipment to enable collection only every two or even three days is gradually increasing thus reducing costs within the dairy chain.

Approximately one half of milk sales are organised through marketing organisations. The strongest one controls about 30 % of milk sold to the processing sector. The average producer price recorded by this marketing organisation exceeded the republic average slightly. Another approximately 20 % of milk sales is controlled by a number of smaller marketing organisations. The rest is sold directly by producers to processors.

From 2005 all direct purchasers of milk have been required to deliver purchased milk to processors only, i. e. no other agents in the sale of raw milk are allowed. For this reason a new registration of raw milk purchasers took place during 2005. In this registration 91 purchasers were registered, 51 processors and 40 marketing organisations. At the end of 2005. 9 of these, 6 processors and 3 marketing organisations left the industry.

6 Expert views on the challenges at the milk processing stage

More than 99 % of processed milk is processed outside farms, i. e. in processing plants. About 60 % of the whole volume of milk is processed in the 10 biggest plants. Daily purchase of 500 000 litres is exceeded by 3 of these plants.

Processing is to a high standard. The vast majority of the processing plants comply with EU standards; only about 6 % of plants do not yet comply. The success of Czech processors is the fact that till now most of them have survived by making huge investments in order to reach EU standards. However previous investments and financial commitments constrain the ability to modernise further to increase production efficiency.

The main contemporary points may be characterised as follows:

- Competition in the raw milk market is growing. Purchases of milk from domestic sources have declined due to its exportation; foreign sources of raw milk are limited, too.
- Competition in the domestic milk products market is strengthening. Exports of milk products are growing much less than imports (see point 2.1). Domestic consumption of milk products is being met increasingly by imported products. Selling domestic products on the Czech market is becoming more difficult. Some kinds of milk products are especially under pressure from imported goods - e.g. cheese, curds. The saturation of the domestic market in a number of areas is high. The opportunities to create new markets seem very limited.
- Continuing WTO discussions suggest a future reduction of export subsidies. The orientation of processors on the production of high value products will become increasingly important.

- The share of milk products being sold through market chains has stabilised at around 70 % in the past four years. Strengthening competition between particular market chains, together with incoming discount outlets is leading all these retailers to seek to increase their market share by driving down the prices of milk products to the detriment of milk processors and the primary producers.
- The quality of Czech milk products corresponds fully to EU standards but the position of the Czech milk processing industry in the international premium market is unfavourable. One possible way to get a competitive advantage and to establish oneself on the market could be the introduction of regional marks and specialities. In this sphere the position of the Czech milk industry has many reserves.

Future development will be influenced and determined by the strengthening competition. The effort to minimize production costs will lead to a drive for the growth of production, the result of which is assumed to be the concentration of processing. The less successful processors are likely to be absorbed by the more successful ones. Strong foreign companies are expected to take the opportunity for to make capital investments in the Czech Republic.

7 Conclusion

The contemporary position of Czech producers and processors of milk puts intense requirements on further produce and business strategy.

The deteriorating trend of producer price of milk is forcing producers to find a way to minimise costs. The possibility of doing this by increasing production is very limited due to milk quotas, which are fully used.

Milk processors face growing competition on the raw milk market due to quotas limiting milk production and exports. Competition in the domestic milk product market is strengthening, too. In two years exports of milk products have increased by 8 % and imports by 90 %. Export of milk products outside the EU, being depended on export subsidies, is more difficult. The high share of milk products being sold through marketing chains inhibits higher product prices.

Formulating a uniform strategy and a general way out is difficult. The future strategy depends on many factors from the area of milk inputs, milk price, activities of particular market participants, development of market regulation, continuing WTO discussions, to the development of consumers´ demand.

In the framework of the existing uncertain conditions, Czech milk producers and processors should focus on the following points:
The question of milk demand remains open. As producer prices tend towards approximate equality throughout the EU, the foreign demand for Czech raw milk could weaken, however we expect that Czech milk will continue to aid to the expansion of processors in nearby countries. In the processing phase the orientation on production of high value products will become increasingly important. The importance of vertical integration of the whole supply chain will strengthen.
The maintenance of the present volume of production and processing of milk in the Czech Republic will require adequate real producer prices for milk and the cooperation of milk producers and processors.