INTAS Project: Supporting the International Development of the CIS Agricultural Sector

An Overview of Findings from the Armenian Case Studies

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Gagik Sardaryan, Vardan Urutyan and Naira Mkrtchyan

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Introduction

This report summarises the key findings from Armenia of Phase 3 of the project, which covered the nature of relationships between dairy processors and farmers and the export performance of dairy processors.

The research on the relationships between dairy processors and farmers involved 8 case studies. In this work, a comparison is made between the supply chain relationships of 4 exporting dairies versus 4 non-exporting dairies to see whether there are broad differences between them. Further research was conducted with the 4 exporting dairies to understand the main trade problems faced and how the barriers to export development may be overcome. Out of 4 dairies, two were classified as successful exporters as the other 2 as less successful (based on the returns and sustainability of export activities). This short report summarises the main findings of both elements of the case study research.

Case Study findings on Dairy Processor Relationships with Farms

Milk Procurement

1.1 Out of eight processors, six started their operations in 2002, with the other two beginning their operations in 2004. Six processors are acquiring all of their milk directly from private farms. Of the remaining two firms, one is buying only 30% of its milk directly from a private farm and the other 70% is from his own herd. The other one is procuring all of its milk from a cooperative farm. Seven processors did not change their buying practices during the years 2002-2006. The processor with its own herd has been steadily increasing the share of milk processed which comes from outside sources, as total output rises. Overall there is little difference concerning the source of milk and whether the dairy is exporting and or is a non-exporter. The processor which buys from a dairy co-operative is an exporter.

1.2 All the processors interviewed mentioned that there was no case of stopping or diminishing the milk purchased from private farms. The exporter-processor which buys from a co-operative has had stable relations with it over the last five years. Some respondents clarified that buying directly from private farms was currently the best option as it gives greater leverage over quality control.

1.3 Most of the processors mentioned that the quality of milk is the primary factor in choosing a particular private farm as a supplier. They argue that only from high quality inputs will they be able to produce final products with sufficient quality for export markets and target value added segments of the domestic market. This fact was stressed several times by exporters-processors during the interviews. One of the producers is choosing a supplier on the basis of proximity, although in this case the processor believes that quality and distance are interlinked because it is easier to control the sanitary conditions and milk quality in those farms which are nearest to the factory. Because every separate farmer is a possible source of low quality milk, the majority of companies are trying to accept a minimum of at least 5 or 10 litres from every farmer, though this minimum quantity can sometimes be relaxed during the winter. Other factors discussed were trust, experience and price. Only two processors mentioned trust and reputation as primary the factors in selecting their farm-clients.

Contracts

2.1 Only five producers are buying milk on the basis of contracts. The four exporters are all using written contracts. The only non-exporting processor which uses contracts in their dealings with farmers uses oral contracts. Two out of these five dairies are buying all of milk on a contractual basis from private farms; one is buying from a cooperative. The other two producers (one exporter and one non-exporter) in 2006 were buying only 70% of milk on a contractual basis from private farms. Three companies did not use any form of contracting.

2.2 All exporter-processors had five main points included in their written contracts: quantity of milk that would be delivered, frequency of delivery, minimum quality requirements, price, and mode and speed of payment. Only two out of the four exporter-processors had penalty clauses in their contracts. Only one exporter mentioned that in the written contract they have a point related to premiums for quality and large quantities, however during interviews it was revealed that although these processors did not mention premiums in their contracts, they pay some premiums for milk quality.

Prices

3.1 In general the minimum and maximum price for accepted milk in the summer season of 2006 was the 90 Armenian Drams (AMD) per litre, which is equivalent to 0.19 euros. This was the same for both exporters and non-exporters.

3.2 On average the minimum price for accepted milk in the winter season 2005/6 was 102 AMD (0.21 euros), the average price for all processors was 116 AMD (0.24 euros) and the average maximum price paid was 119 AMD (0.25 euros). The minimum price that two exporters paid was 90 AMD (0.19 euros) and the other two paid 100 AMD (0.21 euros). The maximum price that was paid by them was 110 AMD and 120 AMD (0.23 and 0.25 euros) respectively. There was no significant difference between non-exporters and exporters regarding the average and range of prices paid to farmers.

3.3 The majority of the processors do not pay any price premiums for delivering larger quantities of milk, except one which was paying a 5 AMD (0.01 euros) price premium per litre and is an exporter.

3.4 Price premiums were mainly paid (five processors) on the base of fat content more than 3.6%, which is calculated according to the following formula:

$$\text{Quantity base} = \frac{\text{Quantity of milk x fat in the milk}}{\text{Fat Base (3.6\%)}}$$

One company was paying up to a 10% premium for milk with more that 3.6 per cent fat content.

3.5 Six processors mentioned that they are paying for raw milk on a monthly basis. Three were exporter-processors. The majority of non-exporters were paying every 15 days during the winter period and once a month in summer. One non-exporter is making payments every 10 days and sometimes even every day, which depends on the demands of suppliers.

Services

4.1 The majority of processors were making advance payments to farmers, which usually varied from 1 up to 5 months and most of them were applying this measure from the beginning of their operations. Usually there was a minimum size requirement for the farmers who are having access to this kind of programs. The minimum quantity is usually set at 10-15 tonnes per annum. This requirement was set mainly by exporter-processors. Non exporters did not have any requirement or size threshold attached to the services that they provide for farmers.

4.2 The non-exporting processors, although in general not using contracts, also provide some support measures like advance payments, quality control, prompt payments, market access, and guaranteed prices almost to all farmers. The primary factor for doing this was trust. Physical inputs were provided by only 3 exporter-processors to relatively large farms. Four companies (two exporters and two non-exporters) were providing transportation services, which involves the transportation of milk from farms to the company. Five processors (3 exporters and 2 non-exporters) provided veterinary support to their farmers and there was no size threshold attached to this support. According to all processors they were implementing quality control, making prompt payments and creating market access for farm products.

4.3 All processors believed that the services and support they provide to farmers by was enabling them to obtain higher quality milk and establish good relationships with farmers. Advance payments enabled farmers to buy feed and hay at a lower price and better quality, which, again has a positive impact on milk quality. It also supported higher yields in winter.

Case Studies of Export Performance

The case studies focus on the four companies listed in Table 1. The actual names of the companies have been withheld to preserve the anonymity of respondents. Processors A1 and A2 were interviewed as successful exporters and A3 and A4 have been classified as less successful cases. In all cases, the dairies are *indirect exporters* in that trade is undertaken by a third party rather than the dairy directly.

Table 1: Case Study of Export Performance

Code	Export performance	Region
A1	Successful	Lori marz
A2	Successful	Siunik marz
A3	Less successful	Gegarkunik marz
A4	Less successful	Lori marz

Section 1. Background information

Both the successful and less successful exporters have had a stable, almost similar, growth in the number of employees and turnover. The growth rate has been comparably larger at dairy processor A2, which is connected to its greater investment in milk production and processing.

For three of the cases Russia is the main export market. The exception is A1**,** for which Russia and USA are equally important. Little screening has occurred and the processors have not exerted huge effort to find export market. It is mainly connected with the fact which exporter approaches them first.

Out of 4 interviewees only **A3** has totally abandoned exporting as the owner wishes to concentrate on the local market: he believes the local market is more important under current conditions and that exporting would weaken his capacity to meet local needs. The A4 is classified as less successful due to the large losses they have incurred in exporting.

Two companies, one successful and one unsuccessful, have received foreign investment. A4 has received financial support from the Dutch Government (no share of equity) and A2 has received investment from a Russian citizen of Armenian descent.

Section 2. Export Attractiveness

All four processors view the profitability of export and local markets as almost identical. The only difference is that in case of export they receive payment as a lump sum in contrast to the local market, where they receive payments in instalments from retailers. Only the firm **A4** considers that the local market is more profitable when compared against exporting.

Section 3. Markets and Strategy

In all four cases the processors have not made any special efforts to find exporters. For three of them, except A2, the exporters and links were identified by an International Agency – the Center for Agribusiness and Rural Development. In all the cases, they rely on the exporter for dealing with distribution of the products.

All four have made changes in packaging and design for the export market and have reduced salt content. They all use high quality input supplies for the export batches. None of them carry out promotional activities. All the promotion was conducted a few years ago by the Center for Agribusiness and Rural Development.

Section 4. Management and Organizational Factors

Exhibitions and personal contacts are the main tools, if any are used, for finding export opportunities. None of the companies has a marketing department or any specific marketing strategy. Similarly no firm has conducted research for finding and expanding export markets. Only one of them (A2) is interested in developing their activities in this field.

The understanding of competitors in export markets is very vague but all firms consider that they are strong vis-à-vis foreign competitors due to the quality of their products.

The main weakness in export market is considered to be a lack of knowledge on the part of foreign consumers about Armenian cheeses. Other problems identified were the lack of promotional activities and knowledge of export markets by local processors.

Official regulations are not considered an impediment by any of the four exporters. Similarly the lack of international standards is currently is not viewed as a major barrier. Meeting the demands of exporters has not been a major problem for any of the producers.

Section 5. Feedback Effects

The main lessons learnt from export markets, which has influenced their activities on domestic markets has been the importance of stable levels of quality and how this depends on the consistent usage of high quality input supplies. Attention to packaging and its implications for transportation has also been heightened as a result of exporting.

Section 6. Environmental Factors and Future Plans

The main barriers to growth are perceived to be problems of transportation (lack of good routes), lack of knowledge about market trends and lack of knowledge of foreign languages. The main impediment to export market development under current economic conditions is perceived to be fluctuations in the value of the Armenian Dram against the US dollar. Also the existence of VAT on the import of equipment is an issue.

Subsidies by the government for supporting export market development are considered important by all the processors. The main role of International Agencies for stimulating export markets is considered the creation of a food laboratory and provision of information on export markets.

Conclusions

- There are few differences between exporters and non-exporters in terms of the source of milk procured, with the majority purchasing solely from individual dairy farms. Only one exporter is entirely procuring milk from a marketing co-operative. Relationships with farmers have been stable in the last five years.

- Milk quality was considered as a primary factor when deciding whether to enter into a relationship with an individual farm to act as a supplier. Trust and reputation received some importance as well by the interviewed dairies.

- All exporter dairies use written contracts when procuring milk. There is a trend among non-exporter dairies to use oral contracts.

- All exporter dairies had the following points in their written contracts: quantity of milk that would be delivered, frequency of delivery, minimum quality requirements, price, mode and speed of payment. Although “premiums” are typically missing from written contracts, the exporting dairies paid some premiums for milk quality. Premiums are paid only for milk quality based on fat content.

- There are no differences between exporting and non-exporting dairies in terms of the prices they for milk.

- Regardless of being an exporter or non-exporter dairy processor, advance payments for milk have been offered by almost all processors. However, there were minimum requirements set by exporter dairies, such as: minimum quantity delivered should be about 10-15 tonnes annually to qualify for advance payment.

- Almost all non-exporters, the majority without contracts with farmers, were also providing some support measures like advance payments, quality control, prompt payments, market access, and guaranteed prices almost to all farmers. The primary factor for doing this was to establish trust.

- Both exporter and non-exporter dairies had the same opinions that services to farmers (support measures) were enabling them to obtain higher quality milk and establish good relationship with farmers.

- All exporter dairies interviewed viewed the profitability of export and local markets as similar. The only difference is that in the case of exports they receive payment as a lump sum, while on the domestic market they obtain payments in instalments from retailers.

- The processors have not exerted huge efforts to find exporters. None of dairies interviewed had a marketing department or any specific marketing strategy. Nor have they conducted research for finding and expanding export markets. Overall, export development strategies are poorly developed.