

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

An Overview of Findings from the Moldovan Case Studies

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1. Introduction

This report summarises the key findings from Moldova 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 10 case studies. In this work, a comparison is made between the supply chain relationships of 4 exporting dairies versus 6 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 the 6 non-exporting dairies, two have ceased exports while the rest have always been focused on the domestic market. The 4 currently exporting dairies are split into 2 successful and 2 unsuccessful cases. This short report summarises the main findings of both elements of the case study research.

2. Overview of the Case Study Companies

During the Soviet era the majority of the forty regional centres of the Republic of Moldova had a milk-processing factory. The restructuring period was characterized by the closing and dismantling of most of these enterprises due to different reasons. Table 1 presents an overview of the main characteristics of the companies selected. To protect the identity of respondents, company names have been replaced with codes.

Table 1: Description of the Case Study Companies

Code	Region	Export
M1	Central	Yes
M2	Central	Yes
M3	Central	Ceased
M4	Central	No
M5	North	Ceased
M6	North	Yes
M7	North	Yes
M8	North	No
M9	South	No
M10	South	No

From the Central region four companies were interviewed: **M1**, **M2**, **M3** and **M4**. These four companies constitute all dairy factories from the Central part of country that have been operating in recent years.

One of the major actors operating in the Moldovan milk processing industry is a 'corporate union' of companies. This group of companies includes two of the largest companies, one which refused to take part in this research and **M1**, plus several smaller factories. Practically all of the milk procured by the group of companies is processed at those two largest companies: the others either process insignificant milk quantities or are not active. This union of enterprises accounts for more than 70% of the milk processed by the Moldovan dairy industry. The union joins five dairies from Moldova and a milk processing company from Ukraine. At present this union of dairy companies is the largest exporter of dairy products from Moldova. **M1** which is part of this union is a medium size company by Moldovan standards. The number of employees of this company slightly increased from 640 in 2002 to 680 employees in 2006. Turnover rose from 8.8 mln USD in 2002 to 10.1 mln USD in 2004, followed by a decrease to around 7 mln USD in 2006. This was mainly due to a reduction in export sales. This factory started its export activities in 2000 when the factory was privatized.

M2 is part of a larger group of companies, owned by a French dairy company and is one of the market leaders in the milk processing industry of Moldova. This company entered the Russian market several years ago but due to the Russian ban on imports of dairy products from Moldova exports ceased.

M3 is a relatively newly created company that produces a range of dairy products but is specialized in the production of special soft cheeses aimed at children. This company launched this range of products on the domestic market. This is a dynamic company that has ambitious plans for the future related to the export of their products. The number of employees of this factory has increased two-fold from 200 in 2004 to 400 in 2006, while the turnover increased about 2.4 times during the same period of time, from 2.2 mln USD to 5.3 mln USD. The factory was privatized in 1999 and only exported in 2004 (to Canada and Bulgaria).

M4 is a small dairy company specialized in the production of a traditional Moldavian soft cheese. This company collects milk from several neighbouring villages and is oriented to the domestic market. However in Moldova they are the unique producers of a special soft cheese with herbs. These products are sold on the domestic markets.

The largest milk processing factories are located in the North of the country because dairy farming has historically been better developed in this part of the country. The sample includes both relatively large and small-scale companies from this region. Thus **M5**, **M6**, **M7** and **M8** represent the Northern region.

M5 is a cheese production factory that restarted its activities several years ago. It is one of the most important cheese manufacturers in Moldova. Exports to the CIS and non-CIS countries were stopped because of the company's lack of competitiveness in these markets.

M6 is one of the largest dairy factories in the country and one of the most important exporters of dairy products. This factory employed about 400 people in 2002 and staffing levels have remained stable during the last five years. For the same time period, annual turnover was around 5.2 to 5.7 Mln USD. The company was privatized in 2002, and currently a French investor owns more than 50% of shares. In the same year as the company was privatised it started to export.

M7 belongs to the same group of companies as **M3** and is specialized in cheese production. During the period 2002 to 2005 this factory employed on average 140 people. Since 2005 this factory has been under a process of modernization and production has ceased. The factory was privatized in 1997 by a foreign investor. The

share of equity owned by the foreign investor is about 70%. This factory started to export its products in 2001 and exports accounted for about 8-10% of total sales during the period of 2002-2005. This factory is interesting from the point of view of technological modernization and for experiences in exporting.

M8 is a small cheese production factory oriented to the domestic market. It produces cheese according to Dutch technologies and was founded according to a joint Moldavian-Dutch project.

M9 and **M10** factories represent the Southern region. **M9** is a new company created on the base of a former milk processing factory. **M10** is a municipal company centred on the production of cheese. These companies process comparative small quantities of milk and have a focus on regional markets. Altogether these factories collect less than 2% of the total quantity of milk procured by all dairy companies in Moldova. Neither is engaged in export activities. These companies are the only active milk processing factories in the southern region of the country.

3. Supply chain relationships of exporting and non-exporting dairies

The main milk suppliers for the interviewed dairy companies are milk-collecting stations, which accounted for around 35-40% of the milk collected during the period 2002-2006 (Figure 1). The majority of the milk-collecting stations belong to the dairy companies.

The second most important source of milk for the analyzed companies, over the whole time period, are co-operative farms. Their average share in the total quantity of milk collected during the period 2002-2006 was approximately 18%. However, during recent years the share of the milk procured directly from private farms has risen substantially and in 2006 their share on average per analyzed dairy companies was around 20%.

The share of the milk collected from “other processors” is relatively stable and has a clear geographical orientation: surpluses of milk collected by dairy processors in the Northern part of Moldova are sold to other dairies from the Central region of the country that have insufficient raw material.

The importance of milk traders is gradually declining because the prices offered by milk collecting stations are more attractive and this explains why more dairy companies switch their activities to milk collecting stations.

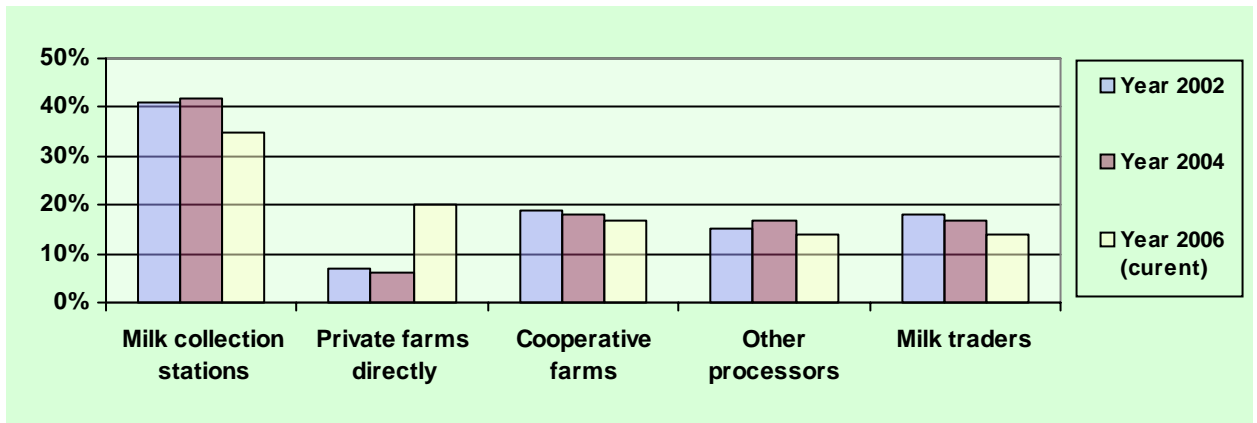


Figure 1: The average share of milk procured from different suppliers, 2002-2006, %

Notwithstanding the small sample size, a comparison is made between the exporting and non-exporting dairies regarding their procurement practices (Figure 2). As a rule exporting dairies are larger and part of wider groups of companies. The non-exporting companies are especially medium and small-scale enterprises focusing on regional markets. As a rule these companies produce niche products. Exporting dairies tend to collect milk from milk collecting stations, milk traders and other processors. The share of milk collected from private and cooperative farms is relatively smaller than for the non-exporting enterprises. Non-exporting dairies do not procure milk from other processors or milk traders.

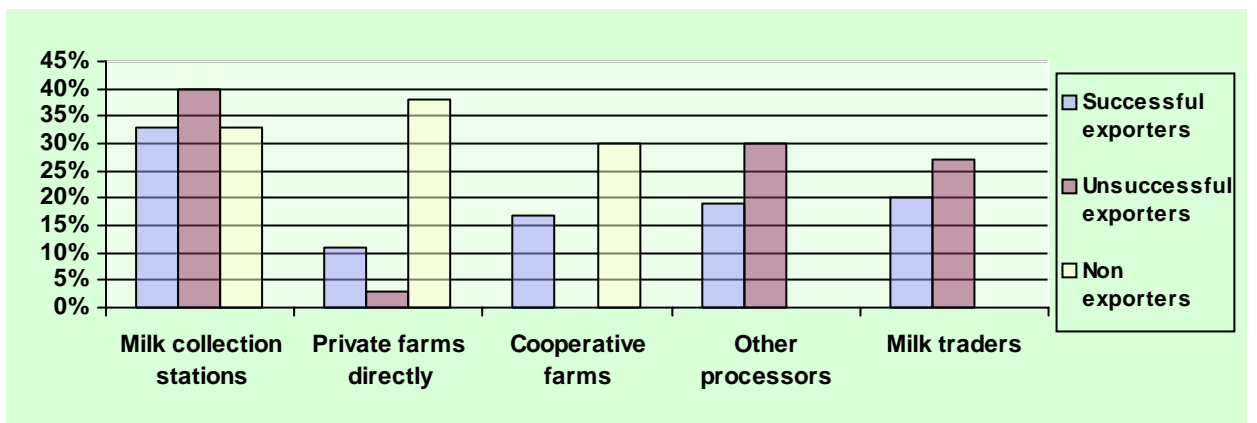


Figure 2: The average share of milk procured from different suppliers by categories of dairy processors, 2006, %

Small dairies largely procure from neighbouring villages and location is critical in their selection of suppliers. For medium and large scale factories the availability of

large milk quantities was of paramount importance. One of the main reasons to change milk suppliers is the delivery of low quality milk.

From the point of view of contractual relationships it is obvious that all interviewed companies procure milk from co-operative farms and milk traders only on a contractual basis (Figure 3). From milk collecting stations, approximately 60% of the milk is procured using a contract. This can be explained by the fact that the majority of milk collecting stations belong to dairies. The percentage of the milk procured directly from private farms using contracts is also around 60%. This is because several small-scale companies procure milk from villages around without contracts. As mentioned by one of the respondents: “Private milk producers trust them that is why they don’t ask for a contract. They just don’t feel any risks”. The relatively low percentage of milk procured on a contractual basis from other processors is explained by the fact that several large and medium scale dairies are part of wider groups of companies and the milk is delivered internally and without a contract.

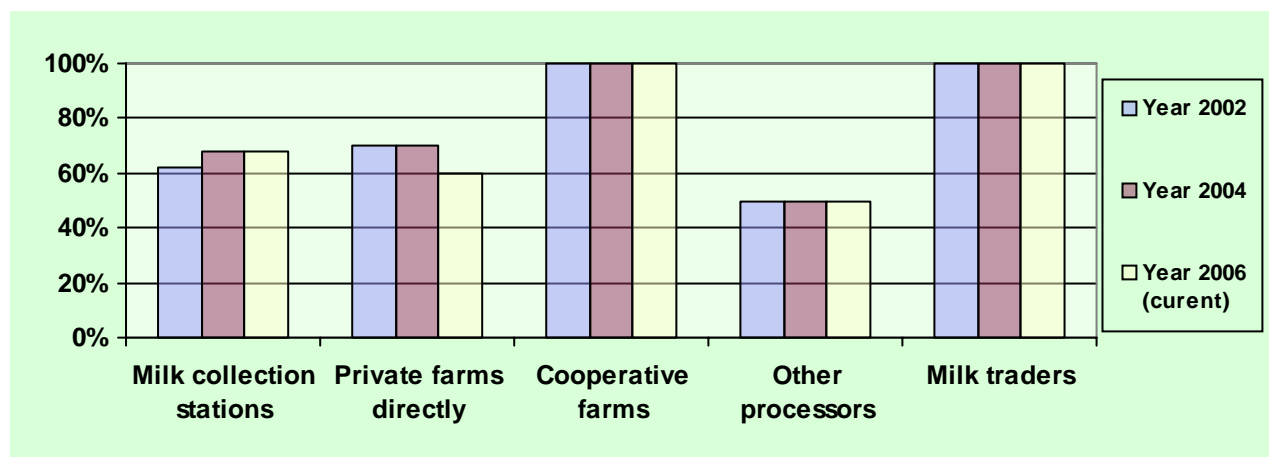


Figure 3: The average share of milk procured using contracts by channel, 2002-2006, %

Regarding the differences between exporting and non-exporting companies, it is apparent that successful exporting companies procure milk from milk collecting stations, private and cooperative farms and milk traders only on a contractual basis, while from other processors milk is procured without any contracts, reflecting predominantly internal transactions (Figure 4).

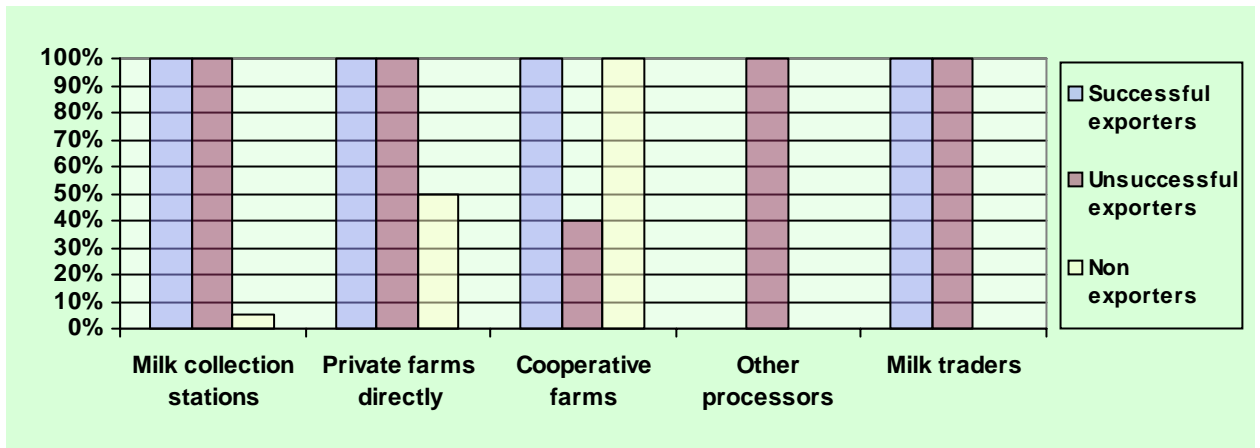


Figure 4: The share of milk supply per type of dairy processor purchased using contracts, 2006, %

Those interviewed dairies that have a negative export experience procure milk from milk collecting stations, private farms, other processors and milk traders only using a contract. At the same time from co-operative farms, on average only 40% of the milk is procured by this category of respondents on a contractual basis.

Price is specified in all contracts signed between dairies and milk suppliers. Minimum quality requirements and frequency of delivery are also included in the majority of signed contracts (Figure 5). Few contracts specify exclusivity or the quantity of milk that will be sold.

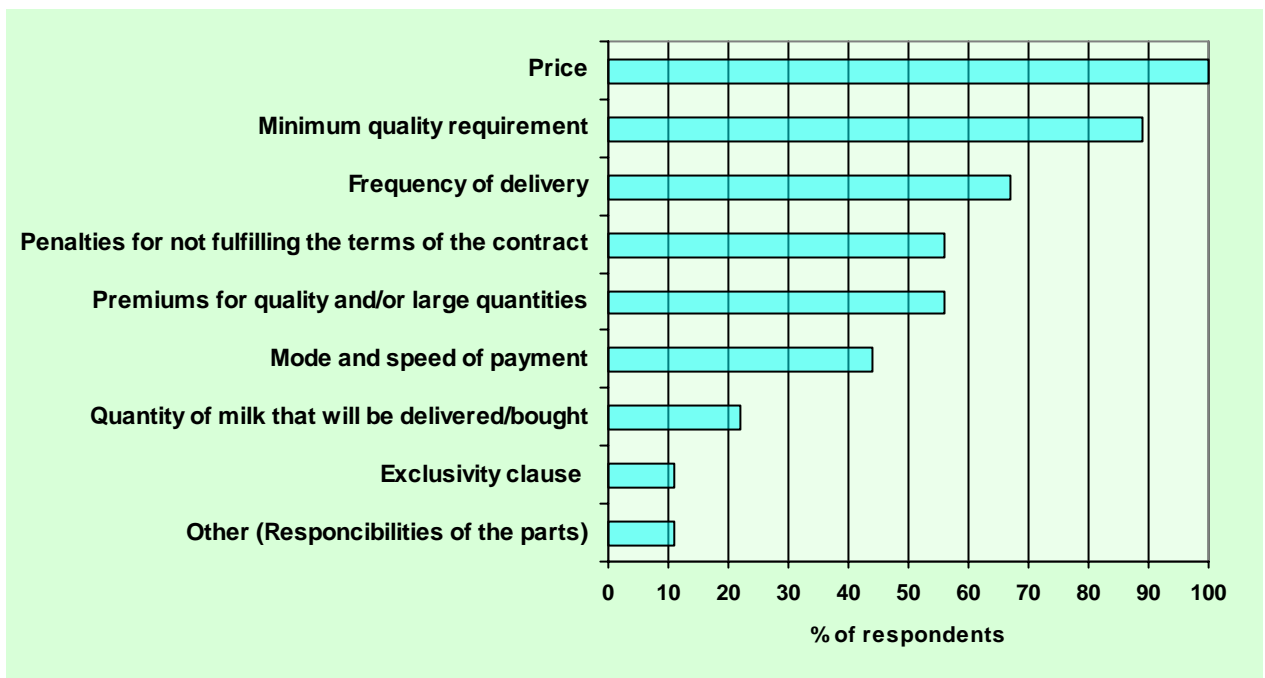


Figure 5: Contract specifications, % of respondents

Analysis by groups of dairies indicated that there are few apparent differences in the content of contracts between these groups.

There are differences, however, between the groups of dairies in terms of the average prices paid for milk (Figure 6). Successful exporters paid on average the highest price (0.1334 Euro/litre) during the summer season of 2006. During the same time period, unsuccessful exporters paid the lowest price of (0,1186 Euro/ltr) Prices paid during the wintertime have not been substantially different.

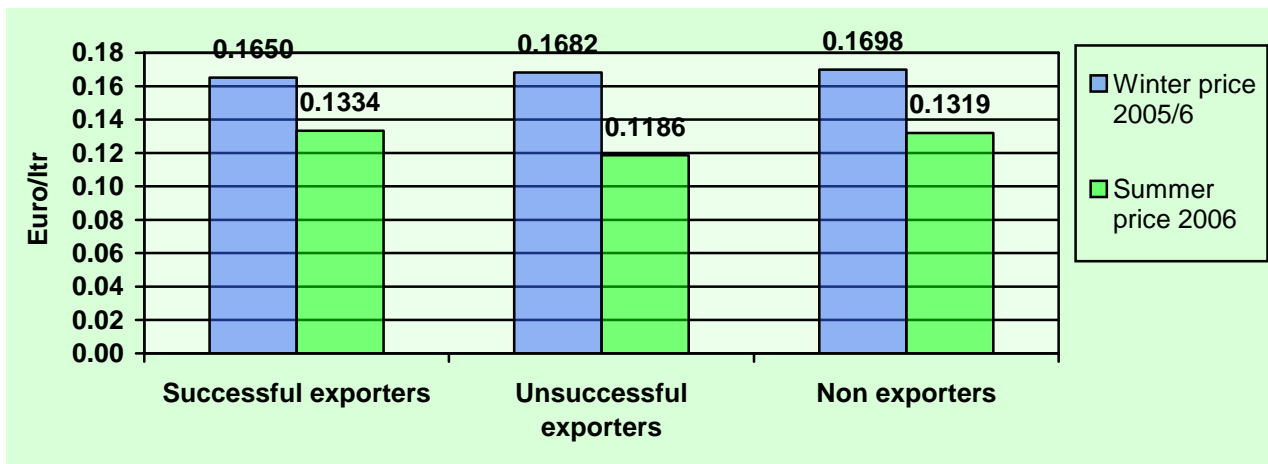


Figure 6. Average prices paid for milk collected by category of dairy, 2005-2006, Euro/litre

The relatively higher prices paid for milk by successfully exporting dairies during the period of excess milk production (summer) acts as an important support measure for milk producers. It contributes to greater commitment in the relationships between farmers and the dairies to whom they supply.

Most of respondents pay a premium price for the delivery of large quantities and higher quality milk. All interviewed factories calculate the milk price on the basis of 3.5% fat content, i.e. in the case of a higher fat content, the price is increased and *vice versa*.

The payment for the procured milk is arranged in different ways such as:

- At the time of delivery;
- Once in two weeks;
- Once per one/two months.
- In advance (fairly rare)

Several dairies also mentioned delays in payment of two to three months caused by cash flow problems. Such cases occur more frequently in summer.

All respondents offer to their milk suppliers: quality control as a contract support measure and, less frequently, specialized storage (such as milk cooling tanks) and transportation. None of the interviewed dairies offer investment loans or farm loan guarantees (Figure 7).

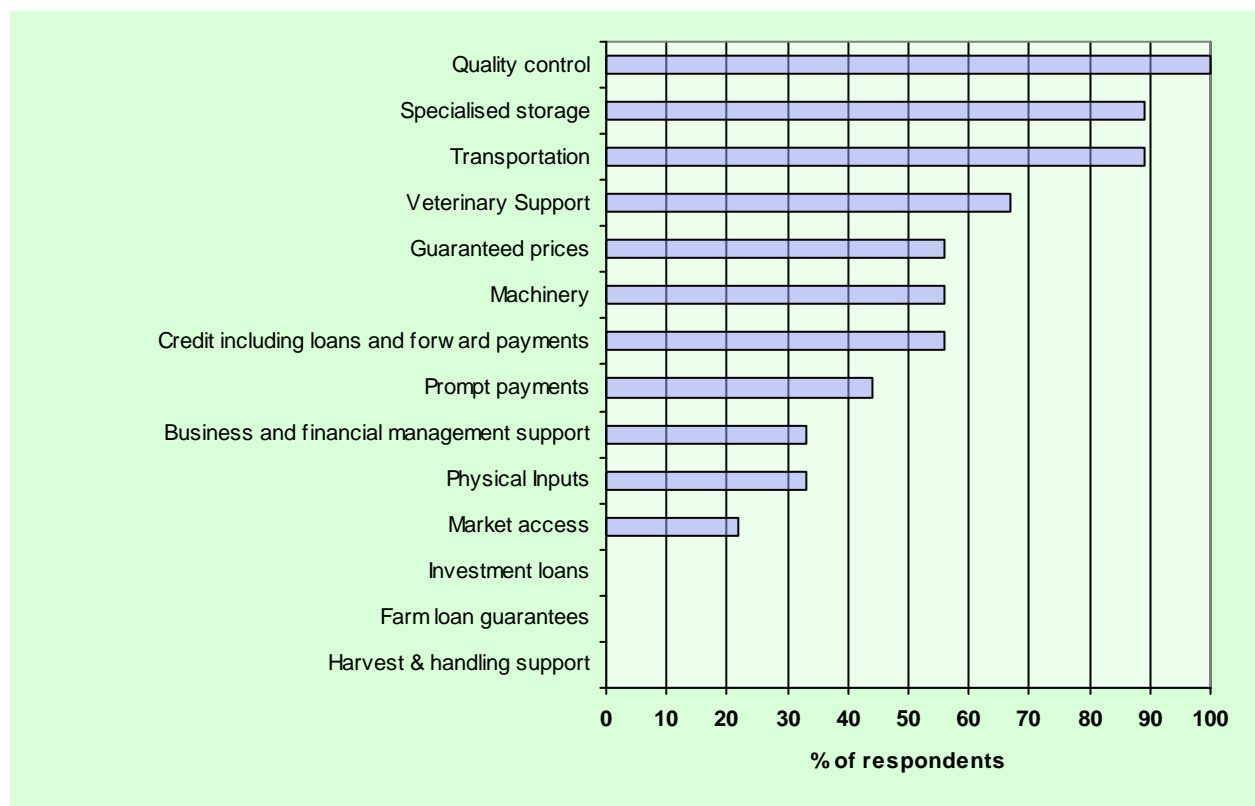


Figure 7. Services offered to milk suppliers, % of respondents

The overall impact of such services is evaluated by respondents as being both beneficial to the dairies and to their milk suppliers. Thus, “Milk producers realized that they have a stable partner that offer an honest price for milk” so that dairies collect larger quantities of higher quality milk. However some interviewees mentioned that “services offered to milk producers are insufficient”, while another respondent affirmed that the impact of such services is insignificant.

4. Qualitative interviews on export performance

Evaluating the profile of successfully exporting dairies it is apparent that they are relatively large-scale companies that collect the majority of the milk they process from the Northern region of Moldova. All these dairies belong to larger groups of companies and typically have a foreign investor. These dairies have superior

knowledge of their foreign competitors and offer higher quality products compared with the offerings of competitors on the export market.

Respondents felt that there was little difference between the attractiveness of export markets compared with domestic ones. The only positive difference is that larger sales volumes can be achieved on the export markets. However logistics are simpler and less costly for the domestic market, and sales volumes are more stable.

Respondents identified significant differences between the marketing of the dairy products in within the CIS and other foreign markets. These two groups of markets have both advantages and disadvantages.

The main reasons for exporting to the CIS markets are the following:

- a) The standards for food products are very similar in all CIS countries;
- b) There is a long experience of exporting to these countries;
- c) There are no language barriers regarding communication with these countries.
- d) There are many cultural similarities amongst the CIS countries.

In the same time the CIS countries are rather unstable and unpredictable markets which are often influenced by *ad hoc* government controls and interventions.

Export to non-CIS markets is perceived to be more secure and farer. Exporting to these markets also allows local companies to adjust the dairy products they sell on the domestic market to higher standards. For instance there are cases where the modification of products according to the higher importer requirements contributed to an improvement of the quality and packaging of the products sold on the domestic market. At the same time export to non-CIS countries involves more complex and often restricted entry, higher logistical costs and different standards.

Exporting to both to CIS and non-CIS markets is effectuated mainly through distributors and export agents.

In order to promote their products and search for new customers the interviewed factories participate at trade fairs, exhibitions and other special events. Several large companies also have their own web pages. Personal relationships remain an important promotion tool.

A peculiar role in sales promotion belongs to the marketing departments as these units focus only on domestic markets only. Market research on domestic markets is disseminated to senior managers who take decisions concerning marketing policy.

Several respondents mentioned that they plan to undertake market research on export markets in the near future. However in companies owned by foreign investors the latter are responsible for undertaking the market research and marketing of their products abroad.

Regarding the main barriers to exporting, all interviewed companies reported the primary barrier to be the political reasons raised by Russia and Ukraine for the export or transit of Moldovan dairy products. Secondly, the competitiveness of Moldavian dairy products on export markets depends on energy costs, because production of the major Moldavian export products such as milk powder and butter requires extensive energy consumption. This is important as energy prices in Moldova are higher than in other CIS countries such as Russia, Byelorussia and Ukraine. Thirdly, the internationalization efforts of dairies are not supported through export subsidies, as in many other states.

Several respondents mentioned administrative problems such as problems obtaining “a veterinary certificate from the Ministry of Agriculture necessary for the export. Because of the lack of this certificate this company was unable to enter a certain export market.”

The long lasting and inefficient process of gaining official recognition for the technical documentation of new products is seen as a major impediment by exporting dairies. This is even more important since according to the information from a respondent “Russia has a programme to change all internal standards for food products” so that Moldovan technical conditions have to take into consideration the necessity of prompt adjustments according to requirements of the export markets.

One respondent mentioned the lack of ISO certification as a barrier: “Our enterprise is not certified according to ISO 9000 or HACCP and this creates us additional problems. But we plan for the future to obtain these certifications”.

An important problem considered by several respondents as a very important one is the unprotected local market. The lack of protection means firstly, the openness of borders for different kinds of illegal operations such as smuggling. For instance a dairy producer mentioned that his export partners showed him the product of his company, namely a pack of butter in the company’s packaging. The most interesting thing was that instead of butter it was margarine, while this company did not produce margarine

at all. According to the interviewed manager's opinion the packaging material could be bought from the company that produced it and cheap, low-grade margarine is easily imported illegally from other countries. Then the "product" is packed somewhere. The presence of such "products" on the market can affect the image of the company and impact significantly on export operations.

Another problem is that the cheap butter "imported" from other countries is often just a mixture of butter and margarine. Being targeted at lower price segments such "butter" creates 'unfair' competition for domestic products. According to a respondent an important impediment is also the poor reputation of our Moldova abroad. Thus, "the bad reputation of the country inspires mistrust in the quality of our products". Moldova in general is not well known for its dairy products. Knowledge of export markets in smaller, domestically owned dairies was also weak. They are in a poor position to internationalise.

Compared with their main competitors on export markets interviewed dairies mentioned that the quality of their products is higher or similar to those offered by competitors. Also export markets require greater flexibility, to adapt to differences in local demand. In several cases the quality of the product was adjusted to the peculiar requirements of the export market, e.g. "we produce butter with higher fat content according to the requirements of a specific customer".

Moldovan producers are largely price takers on international markets, so that what they receive is dictated by the going rate on foreign markets. Generally Moldovan products are positioned at a lower price for the similar product quality.

Among the main "strengths" of Moldovan companies, when competing on export markets was mentioned the "quality of our products" and the ratio of price to quality: "the price of our products is lower for the same quality".

According to a respondent, Russia's ban for the import of dairy products from Moldova forced exporting companies to change their strategy for searching new export markets: "These problems with export to Russia make us look for other export markets besides Russia". Another respondent mentioned restrictions imposed by Ukraine for the transit of Moldavian dairy products that coerced exporting companies to find different ways to export to Russia avoiding the transit via Ukraine.

According to respondents, International Development Agencies should support programmes to harmonise national legislation to international standards.

In summary, respondents' that export performance depends on:

- a. The elaboration and implementation of the short and long term strategy for entering foreign markets;
- b. Searching for opportunities to enter new markets and re-entry to the CIS market.
- c. Modernization of the utilized technologies and procurement of the necessary equipment in order to be able to produce what is demanded on export markets;
- d. Further diversification of the range of products and market segments so that they are not solely confined to a low price position.