African markets could boost South African food value chains

The prices of essential goods and services are escalating at a higher rate than consumers are earning, which results in decreased consumer spending power and a negative impact on the retail and food processing sector, as well as farmers. However, many sub-Saharan countries are growing at 6-7% pa, fuelled by rapid urbanisation and a rising middleclass. This creates opportunity for food value chains originating in South Africa to enter new, high growth markets either through exporting or through setting up operations in country.

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Industry under pressure

"The average grocery trolley in the supermarket cost just over R400 in December 2013, which was up by only 1.6% from the previous period. This indicates that consumers are cutting back, as this increase is more than 4% below the inflation rate," says Herman Marais, managing partner at Agri-Vie, a private equity investment fund focused on food and agribusiness in Sub-Saharan Africa. Its mission is to generate an above average investment return and demonstrable socio-economic development impacts through equity investments.

Retailers are feeling the impact of dwindling consumer spending power and food processors are being pressurised by price resistance at retail level, with labour and energy costs rising dramatically in the recent past.

"Traditionally, the South African food manufacturing sector, like the rest of manufacturing in South Africa, was to a large extent built on the basis of competitively priced energy (electricity) and labour costs, however, South Africa's increased labour and energy costs have become less competitive in comparison to global peers."

This has resulted in a structural change for the worse within the food-manufacturing sector. He refers to the results of the Deloitte 2013 Manufacturing Competitiveness survey for South Africa, which suggests that South Africa's competitiveness ranking will decline over the next five years.

"Cost and availability of labour and materials are the highest rated factors by South African manufacturers contributing towards competitiveness. Unit labour costs (the ratio of wages to labour productivity) in the manufacturing sector rose by an average of 5.8% per year from 1998 to 2012. Over the same period, unit labour costs in many European countries have fallen due to productivity gains. In addition, man-days lost to a surge in industrial action since 2012, particularly in the mining, agricultural and transport sectors, are likely to have had a negative impact on manufacturing productivity."

Furthermore, the survey revealed that for much of the past three decades, electricity prices in South Africa have been low and declining (in real terms). From 2008, however, the trend in real electricity prices took a dramatic turn and increased by 78% between 2008 and 2011. The sharp and sudden increase in energy costs, coupled with an unfavourable economic climate, put many food manufacturers under near-fatal pressure.

Farm Requisites Price Index doubled

"The all Farm Requisites Price Index (FRPI), which is the official measure of the increases in prices of farming inputs, has more than doubled in the period since 2005, while the PPI (Producer Price Index) has experienced a materially smaller increase. The input costs that have mainly contributed to this increase have been fertilizers, herbicides, pesticides, energy and equipment, to name but a few.

"Therefore farmers, who by nature stand at the back of the local food value chain are currently in the weakest position as they bear the brunt of rises in input costs while having little leeway to pass on higher prices to food processors and retailers."

Strategies to overcome challenges

The company has invested in a portfolio of food and agribusiness companies that share many of the above challenges. "The team works actively with its investee shareholders and company management on proven strategies to contend and overcome these challenges."

These strategies include focusing closely on the following key elements:

- ***Focusing on quality as well as reliable delivery:*** characteristics that set thriving companies apart from average companies. Several of its investment companies have consistently won customer recognition awards for their quality products and delivery strike rates

- ***Continuous improvement programmes to streamline business processes:*** unrelenting focus on cost-efficiencies through constantly questioning each aspect of the business pays rich dividends

- ***Scale:*** investing in growth companies and work with these businesses to achieve economies of scale in their operations which ultimately improves margins. Both organic and acquisitive strategies are pursued

- ***Vertical integration:*** Forwards and backwards vertical integration create strong supply chains with greater efficiencies as well as cost advantages

- ***Value chain partnerships:*** Experience has shown that participants in business value chains that adopt a broader perspective across the entire food value chain ultimately fare better than those concentrating only on their narrow self-interest will.

- ***New markets:*** While the South African market for food products remains in a low growth environment, the same applies to many of South Africa's traditional export markets in Europe, where recovery is still at a very early, fragile stage. The company, with its long-standing operations in several countries in the region, works with its investee companies to do that

- ***Focus on sustainability:*** Global research into corporate performance confirms that a focus on environmentally and socially sustainable business leads to superior financial performance in the longer run while also being good for people and the planet. The company enters into a compact with its investees, aligning on globally recognised sustainability standards and practices.

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