

THE FOOD AND DRINK INDUSTRY IN IRELAND

CLOSING THE GAP

Competitiveness Indicators 2009



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SUMMARY AND RECOMMENDATIONS

The food and drink sector is highly innovative and efficient, with strong domestic and export markets. It uses as raw materials the majority of the output of Ireland's agricultural sector. The impact of the sector in terms of direct and indirect employment can be felt in all regions of the country. It is a significant contributor to net foreign earnings.

More so than any other sector, the full extent of the supply chain – raw materials, production and processing, logistics, sales and marketing, professional services and headquarters - is located here in Ireland. This means that the regulatory environment affects the sector more than any other. Framework policies like CAP, energy security, climate change, sustainable consumption and waste through to specific regulations and directives on animal health, food safety and consumer information all have a bearing on the industry. Regulation must be evidence based and co-regulatory approaches should be given preference.

All aspects of the supply chain are also affected by a complex, difficult and fast changing business environment. Commodity price volatility, euro appreciation, energy and other business costs, retail buying power etc, all affect our competitiveness.

Electricity, waste and other input costs are significantly higher than those of our competitor economies. This puts the food and drink industry at a disadvantage both in export and in the domestic market where foreign competition is a reality.

To these general factors can be added the high degree of retail concentration, tilting the balance of power in favour of retailers and the requirement for a greater level of co-operation between third-level institutions and industry in relation to R&D.

RECOMMENDATIONS

- A national priority must be to bring costs back in line with and ultimately, below the EU average. Energy costs in particular, currently the second highest in Europe, need to be reduced to the levels of competitor economies through an emergency review of tariffs and alternative funding mechanisms for energy infrastructure.
- While 43% of food exports go to the UK, sterling has fallen in value by 30%. Supports are needed as a matter of urgency for enterprises exposed to such crippling currency movements including a temporary suspension of employers' PRSI payments in labour-intensive industries like food and special marketing compensation grants to overcome exceptional market distortions.
- Credit availability needs to be improved and a workable export credit scheme with a state-backed guarantee needs to be introduced.
- The temporary state aid measures introduced by the EU Commission in December 2008 are insufficient, and the Government should seek approval from the EU Commission to set aside state aid rules and provide grant aid to companies to assist them put in place productivity enhancing measures.
- Greater links need to be developed between third-level institutions and industry and publicly funded research needs to reflect industry needs. R&D is central to product innovation, processing efficiency and consumer safety - it is a key driver of growth.
- The skills of graduates must also reflect industry needs and development agencies need to place a greater emphasis on the research absorption capability of SMEs.
- A legal framework needs to be put in place to ensure responsible trading practices between grocery retailers and their suppliers.
- An ombudsman is required to investigate complaints of irregular practices or abuse of power.
- The legislation should ensure that suppliers are not forced to pay for advertising, display of goods or 'hello money' unless there is a clear benefit to both parties.



ECONOMIC VALUE OF THE FOOD AND DRINK SECTOR

The food and drink industry is Ireland's most important indigenous sector. It has a gross output of over €18 billion and supplies most of our domestic food needs. Total exports exceed €8.1 billion and the sector accounts for two thirds of all exports by indigenous industry.

The industry is closely linked with agriculture in all regions of the country, and accounts for most of its output. In this sense, the industry is unique in Ireland, integrated as it is with the majority of raw materials produced and processed here and distributed either nationally or overseas. In addition, the industry is headquartered here and has developed most of its intellectual property here also.

As a consequence of this, food and drink is affected more than any other industry by the business, regulatory and policy framework in Ireland and the associated cost base.

Ireland's food and drink industry has shown an ability to innovate, add value and develop new export markets, making an increasingly significant contribution to the country's economy. In order for this to remain the case, policy makers must ensure that the industry's competitiveness is not just maintained but improved.

THE INDUSTRY AT A GLANCE

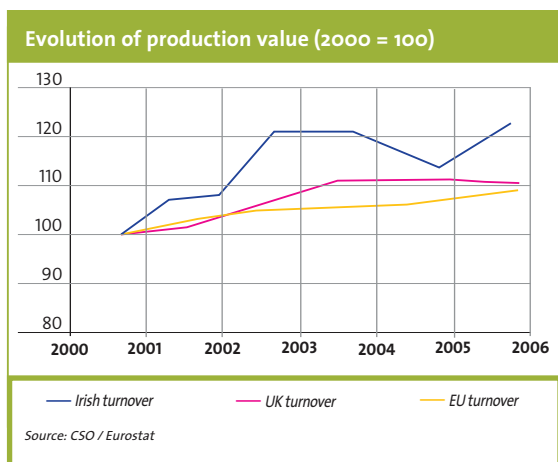
- The Irish food and drink industry has a gross output of over €18 billion
- Under traditional GDP measurements the sector accounts for over 8% of total GDP and over 18% of GVA in manufacturing
- The sector employs 46,000 people directly and 60,000 people in distribution and other services
- It purchases over €5 billion worth of agricultural products from Ireland's 120,000 farmers annually
- Total employment linked to the sector is almost 230,000
- It supplies the majority of the €11 billion worth of food and drink products that we consume annually
- It exports over €8 billion worth of food and drink products to 120 countries worldwide annually and accounts for €5 billion (66%) of exports by indigenous manufacturers
- It purchases € 8.4 billion worth of Irish goods and services – almost 50% of the total sourced by manufacturing industry in Ireland
- Taking capital flows and links with the domestic economy into account, the sector is the largest wealth generator in Irish manufacturing industry



A. MAIN COMPETITIVENESS INDICATORS

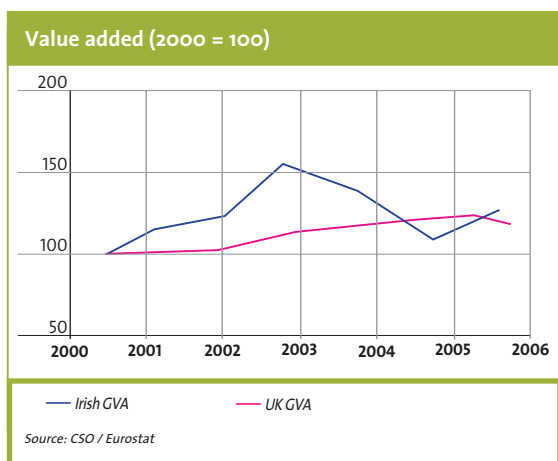
1. PRODUCTION VALUE

The production value of the Irish food and drink industry grew strongly between 2000 and 2006 (with further growth experienced in 2007). This compares with slower growth in both the UK and EU generally.



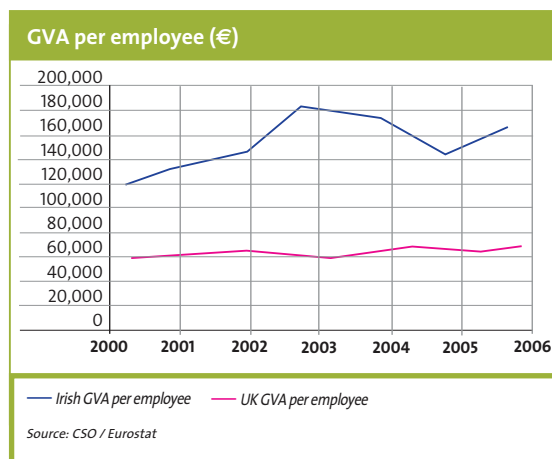
2. VALUE ADDED

While gross value added (GVA) in the Irish food and drink sector varied between 2000 and 2006, it has generally been ahead of the UK.



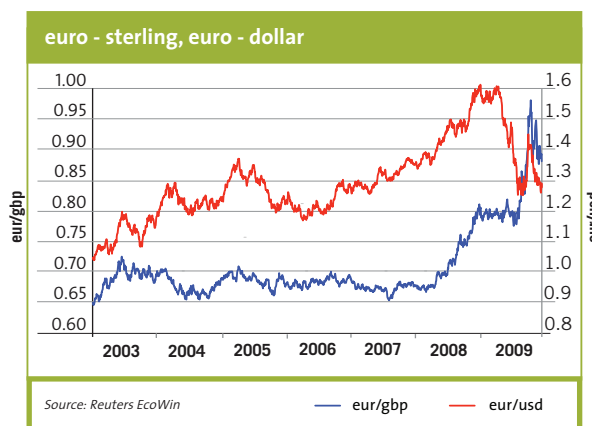
3. PRODUCTIVITY

GVA per employee has been on an upward trend since the start of the decade and is significantly higher than the UK. This reflects structural changes in the industry as it has experienced consolidation and higher levels of productivity to meet the challenges of increased customer buying power, growth in export markets and the move to higher value added output.



4. CURRENCY

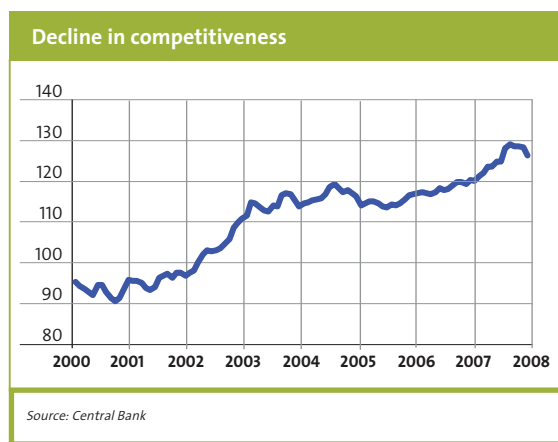
The Euro zone accounts for 30% of the sector's exports. With a strong Euro and 43% of exports going to the UK/sterling area, Ireland's food and drink industry is heavily exposed to currency fluctuations. In addition, the balance of 27% goes to non-European countries and in many instances is denominated in dollars. Therefore, a currency risk exists for over two thirds of Irish food exports, and underlines the need to maintain competitiveness by controlling domestic business costs.





5. HARMONISED COMPETITIVENESS INDEX

The Harmonised Competitiveness Index for Ireland shows a 32% decline in competitiveness since the start of the decade. Ireland's loss of competitiveness in recent years has occurred due a combination of exchange rate factors and larger increases in our cost base compared to those experienced in the countries with which we trade. (Note: an increase in the index indicates a fall in competitiveness.)



6. CONCLUSION

Despite significant increases in productivity and value added in the food and drink industry, rising business costs and a strengthening euro have caused a significant deterioration in the competitiveness of the sector, reflecting that of manufacturing as a whole. With 43% of food exports going to the UK, sterling has fallen in value by 30%. Supports are needed as a matter of urgency for enterprises exposed to such crippling currency movements including a temporary suspension of employers' PRSI payments in labour-intensive industries and special marketing compensation grants. The Government should seek approval from the EU commission to set aside state aid rules and provide grant aid to companies to assist them put in place productivity enhancing measures.

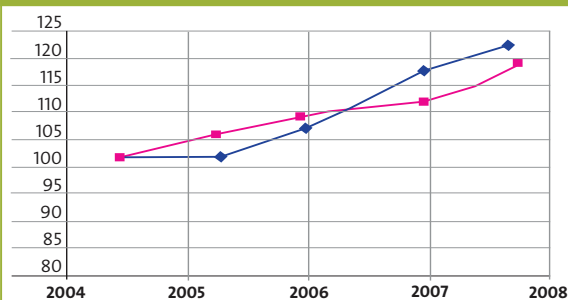


B. BUSINESS INPUT COSTS AND AGRICULTURAL RAW MATERIALS

1. RAW MATERIAL PRICES / FACTORY GATE PRICES

Raw material prices have risen significantly since 2006. Combined with large rises in other input costs, particularly energy, these have placed huge pressure on suppliers who have been unable to achieve full cost recovery in the market place. This has placed downward pressure on margins with long-term effects on investment, innovation and the survival of some companies.

Prices - farm gate, factory gate and retail (2000 = 100)

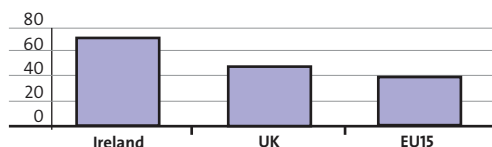


Source: CSO

2. ELECTRICITY PRICES

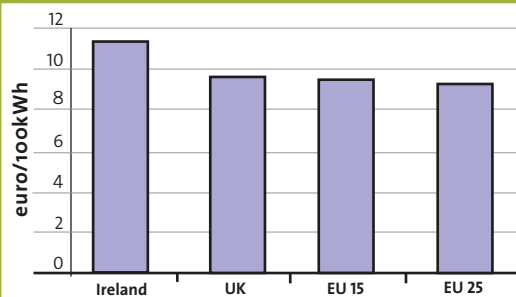
Between 2001 and 2007, Ireland experienced the second highest increase in industrial electricity prices in the EU at 70%. This compared to 47% in the UK specifically, and an EU 15 average of 36%. By 2007, Irish industrial electricity prices were the second highest in the EU 25 and almost 19% above the average. The food and drink sector is particularly exposed to higher prices as on average, energy tends to be the largest input cost once raw materials are excluded.

Percentage increase in industrial electricity prices (2001 - 2007)



Source: Eurostat

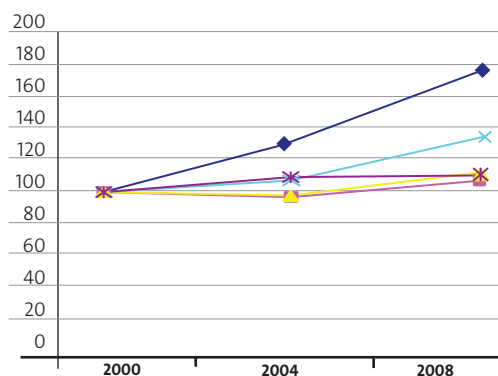
Industrial electricity prices (2007)



Source: Eurostat

In addition, increases in input costs such as electricity have not been recovered in output prices by the food sector. The 77% increase in electricity prices since 2000 far outstrips the factory gate price increases for food products, which averaged 19% over the same period according to the Wholesale Price Index from the Central Statistics Office (CSO).

Wholesale price index



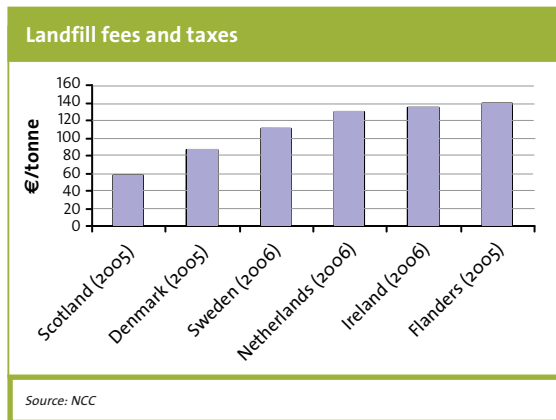
Source: CSO

Electricity, Consumer Foods, Meat Products, Dairy Products, Beverages



3. WASTE CHARGES

Food waste accounts for a significant portion of industrial waste¹. Although a significant quantity is recovered, the primary waste treatment solution that is available in Ireland is landfill. Landfill charges are among the highest in Europe.



When examined at a local level, the difference between Ireland and the UK is even more pronounced.

Waste disposal costs per tonne (2007)

Dublin	€182
Belfast	€78
London	€70
Manchester	€57

Source: NCC

4. CONCLUSION

Electricity, waste and other input costs here are significantly higher than those of our competitors. This puts the food and drink industry at a competitive disadvantage both in export markets and in the domestic market, where foreign competition is a reality. A national priority must be to bring these costs back in line with and ultimately, below the EU average. Energy costs in particular, currently the second highest in Europe, need to be reduced to the levels of competitor economies.

¹ EPA National Waste Report 2006

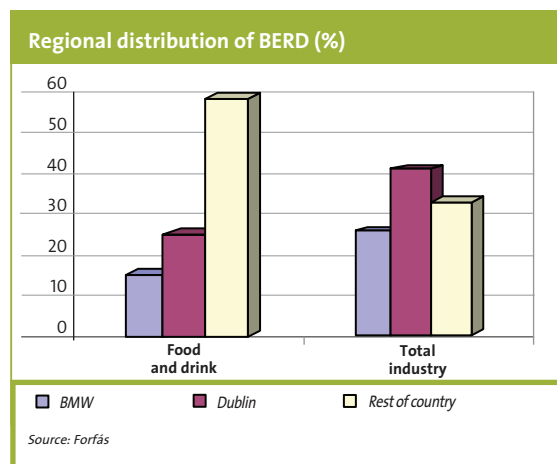
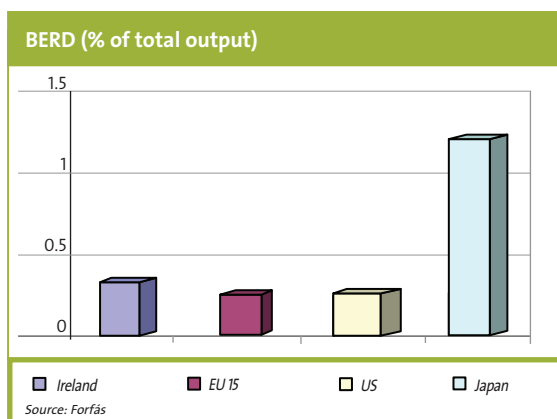


C. R&D INVESTMENT AND INNOVATION PERFORMANCE

1. BUSINESS EXPENDITURE ON R&D (BERD)

BERD for the food and drink sector reached €64 million in 2005, representing a 12% increase over 2003. This equates to 0.35% of output and compares well with the EU 15 average of 0.24%.

The fourth Forfás Community Innovation Survey showed that 80% of firms in the food, drink and tobacco sector were engaged in innovation activity. The regional distribution of BERD also reflects that of the food and drink sector with a strong regional spread, and particular concentration in the south and east of the country.

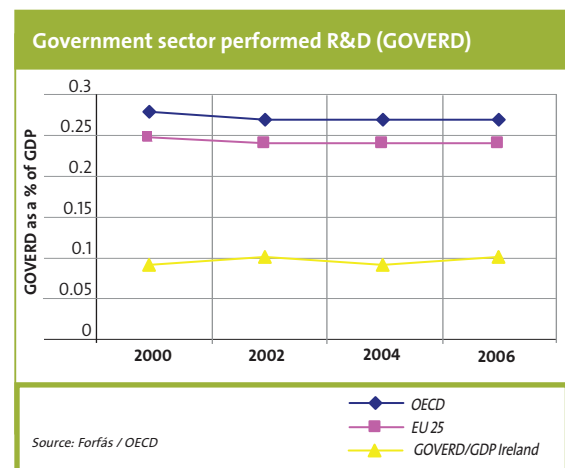


2. GOVERNMENT-FUNDED R&D

A total of €5.922 billion will be spent on science, technology and innovation over the course of the National Development Plan (2007 – 2013). Within this figure, €641m (11%) has been allocated to the Agri-Food Research Programme. This includes funding for:

- Teagasc research activities (to include capital expenditure on an animal science centre, functional food laboratories, clinical trials facility and nutraceutical research facility);
- Department of Agriculture, Fisheries and Food agriculture and veterinary laboratories;
- competitive research programmes including FIRM.

Forfás measures Government-funded R&D (GOVERD), which shows that despite significant investment, Ireland remains below EU 25 and OECD levels.



3. LEVEL OF EMPLOYMENT IN R&D

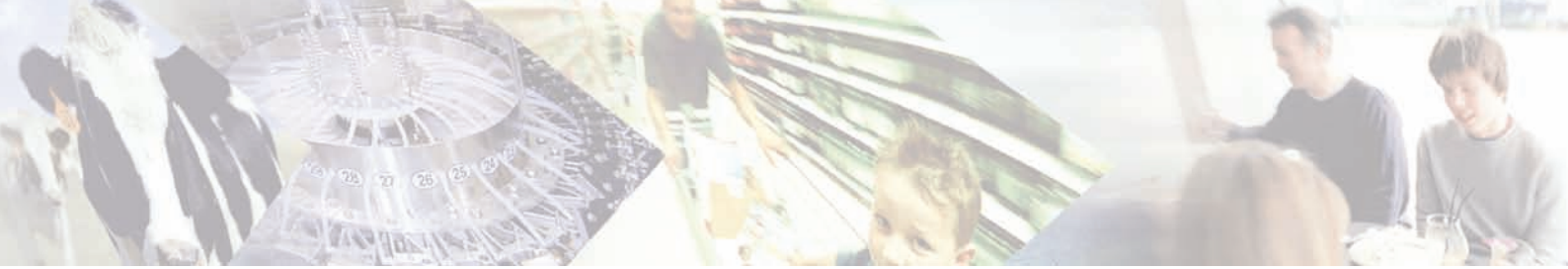
There were 1,085² research personnel (researchers, technicians and support staff) working in the food and drink sector in 2005. This was an increase of 58% over 2003.

² Research & Development Performance in the Business Sector Ireland 2005/6, Forfás 2007



4. CONCLUSION

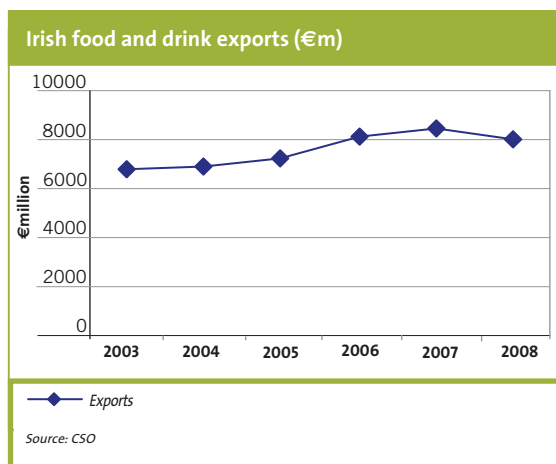
The significant private and public sector investment in R&D must be aligned with the needs of the food and drink sector to allow the industry to develop and maintain competitive advantage through product innovation, processing efficiency and advances in consumer safety. Greater links need to be developed between third-level institutions and industry with graduates' skills more closely aligned with industry's requirements. Finally, development agencies need to place a greater emphasis on the ability of SMEs to absorb new research.



D. TRADE PERFORMANCE

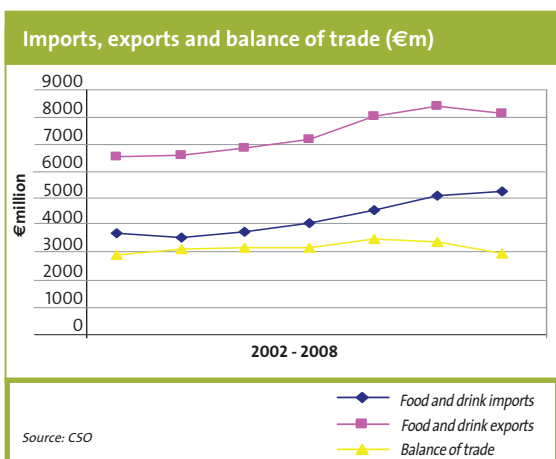
1. EXPORT GROWTH

Until recently, Irish food and drink exports had been growing steadily in both existing and new markets. Despite ongoing diversification, the UK remains the largest single market, accounting for 43% of exports in 2008. The rapid and substantial weakening of sterling since late 2007 has placed extreme competitive pressures on Irish exporters in that market with exports falling by 6.5% in 2008.



2. TRADE BALANCE

Strong growth in exports has been matched by similar growth in imports. The overall trade balance is strongly positive and is now approximately €3 billion. The strength of the euro against sterling and the dollar since late 2007 has had a negative effect on both exports and imports.



3. CONCLUSION

Widening the trade balance will only be possible by improving the competitiveness of the sector through greater control of business costs and commercially-focused innovation. Because the sector has such a strong export focus and high working capital requirements it needs access to credit insurance, greater availability of banking credit and marketing supports in export markets.



E. RETAIL BUYING POWER

1. GROCERY RETAIL SECTOR CONCENTRATION

High levels of concentration in the grocery retail sector have resulted in an imbalance of power between suppliers (food suppliers) and their customers (retailers). Ireland has one of the highest levels of concentration in Europe, surpassed only by the Nordic countries and Switzerland.

Market share of top three retailers (2008)

70.5%

Each of the top three grocery retailers has domestic sales in the €2 to €3 billion range, which are many times the sales of even the largest food companies.

From an exporter's perspective, high levels of concentration also exist in the top three export markets.

Market share of top three retailers in the top three export markets (AC Nielsen 2004)

France	64%
UK	58%
Germany	55%

2. CONCLUSION

Because of high levels of concentration, the bargaining power of retailers is considerably higher than that of their suppliers. There is an urgent need for the introduction of legislation to ensure balance in the commercial relationship between suppliers and retailers. This legal framework should ensure:

- responsible trading practices between grocery retailers and their suppliers;
- an ombudsman to investigate complaints of irregular commercial practices or abuse of power;
- suppliers are not forced to pay for advertising, display of goods or 'hello money' unless there is a clear benefit to both parties.



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