

Strategic Opportunities from AgriBiz Localisation

*Part 1: Impact of Consumer Megatrends on
Agribiz Supply Chains*



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Part 1: Impact of Consumer

Megatrends on agribiz supply chains

By Michel Brekelmans

Up until the mid-eighties of the last century, agri-trade was predominantly regionally focussed. Trading across the world only started to take off when excess palm oil needed to be moved to buyers around the world. Global supply chains developed which led to many other agri products being traded on a global basis.

Now, due the impact of several industry megatrends, many industry players are speculating whether trade patterns are moving back in the opposite direction towards regionalisation or even localisation of agri supply chains. The impact on industry stakeholders of such a shift would create significant opportunities and challenges for businesses across the agri value chain.

Several key factors are increasing the trend towards localization:

Demand Drivers

- Increased focus on healthy products
- Premiumisation & Farm-to-Table
- Globalising Diets
- Rising middle class in emerging markets driving agri-flow changes
- CPG players struggling with innovation

Supply Drivers

- Covid-19 restrictions on farming and supply chains
- Farming industrialisation and genetic innovations
- Drive towards farming sustainability
- Potential for localisation for intensive farming
- Local biofuel policies
- Increased trade restriction

In this paper we summarise key implications of these trends for agribiz players based on discussions and projects with several leading industry stakeholders. We will focus on the demand side trends and will cover supply side trends and implications in a subsequent paper.

Covid-19 accelerates consumer focus on health

Like most industries, the agribiz and food and beverage industries have seen major impacts from the Covid-19 pandemic, albeit less pronounced compared to for instance the tourism or airline industries, as people need to continue to eat. Also, the impact of the pandemic differs markedly by specific product. For instance, edible oil pricing is driven by biofuel demand and fuel consumption initially went down dramatically during the pandemic which had a major impact on vegetable oil prices.

The pandemic has accelerated consumer interest in healthy products and lifestyles

The pandemic has had a major impact on consumer behaviour which is having knock-on effect on agri supply chains. As people went less to restaurants in developed countries like Singapore, the EU and in North America, consumers were more willing to spend more on products that they buy in the supermarket. It accelerated the trends towards premium products such as organic products, products that are perceived as more healthy and locally grown products. As they spent less outside their home, consumers were more inclined to pay a premium for products that have a higher quality and are considered more natural and healthier.

The pandemic has resulted in an acceleration of demand for more premium products: organics, sustainable and local products. People have a higher tolerance to pay a premium price and the trend towards more natural products and more conscious consumption has been accelerated because of Covid-19. Consumers are more focussed on buying healthy products and developing a stronger immune system. This was already happening before the pandemic but the trend has accelerated, especially in countries with higher incomes.

As health issues are becoming more important to consumers some agri products are facing increasing headwinds. For instance, in

tobacco, Asia is one of the last bastions of trade in cigarettes. Indonesia, Japan, Korea and China are some of the few markets in the world where cigarettes are still doing OK but elsewhere demand is even more sluggish as a result of the pandemic. There is global resistance around the world to smoking tobacco and we think eventually this will reach Asia as well.

Also, looking at fatty foods, the use of palm oil is increasingly raising resistance in Western markets, also because of deforestation associated with palm oil plantations. There is big resistance in Europe on the use of palm oil despite Malaysia and Indonesia demonstrating they are controlling deforestation much better than before. It is likely that the restrictions on palm oil will keep increasing over time.



Premiumisation and Farm-to-Table

With increased focus on health, customers are also increasingly interested to buy products grown close to home: the farm-to-table movement. People want to eat locally grown products and this is a trend we see around the world. This started as a niche trend but we think it will become more important in premium product categories, including organic products, products with sustainability certificates and locally produced products.

To illustrate, you can buy standard sunflower oil for a few dollars or sustainable bottle with sustainability mark and pay a premium of \$20-25 per bottle or you can buy organic at \$300 per bottle that is fully certified, has no pesticides during growing, no chemicals during processing, etc.

Premiumisation in a bottle: price of a 1l bottle of sunflower oil

Standard  \$3-4

Sustainable  \$20-25

Organic



\$200-300

The trend towards premiumisation in agri-biz is interlinked with more localised sourcing of products. For instance, consumers in Europe who want to buy organic products often insist it has to come from the EU. On the one hand because they want to buy local products but also, when you are paying a premium for sustainability and non-GMO organic products, some locations are not considered reliable. Many customers are willing to pay a premium to make sure their sunflower oil is not coming from the Ukraine, Russia or Rumania since it is not reliable. So suppliers will need to have a certificate of origin and transport, storage and processing all needs to be segregated.

Consumers are increasingly interested in enjoying local products, that are healthier and better for the planet. Previously this desire for local products was only there for certain premium products, like sirloin steaks from certain a region from Spain. And France has always had strong local identities associated with its wines and cheeses for instance. But now it is more and more a major trend across many agri-categories. Supermarkets are playing an important role in promoting this: Olive oil from Valencia, strawberries from Kent, etc. Even McDonalds is advertising that their meat is coming from a certain region to justify a premium.

Differences in consumer perceptions on food health complicates life for global CPG players

Often there is not a huge clarity from the consumer perspective in terms of what is healthy, what is natural or what is organic. Regional differences in what is considered healthy complicates things further. This means that if you run a local business with local customers you need a very different approach compared to when you are looking at this from a global MNC perspective. For instance, in Europe, demand for palm oil from a food perspective declined from 3.6m ton in 2010 to 1.8m ton in 2020. But in China palm is considered healthy and people don't worry too much about deforestation of rainforests in Indonesia.

Also, some countries don't have a good self-image in terms of quality or safety of local agri-products. In China, food manufacturers prefer to pay a premium so they can show to customers that they are working with imported ingredients. This is for example the case for baby formula, cereals for infants and other products for babies and toddlers. Vegetable oils are key ingredients in the production of these products, typically in the form of a mixture of sunflower, rapeseed, and palm oils. For these sensitive categories, Chinese food manufacturers, are willing to pay a premium for imported products. COVID-19 has led to some substitution for local supply due to import restrictions but overall the preference for imports remains strong.

Globalising Diets

Besides this trend toward buying more local and organic premium products, there is also a trend where consumers are expanding their diets from regional diets to global diets. In the US, Portland is

the Silicon Valley of food innovation where you can get everything from Singapore pepper crabs and Vietnamese pho to Chilean cazuela. Across Asia, we see the same trend where consumers are embracing international diets and products from avocado and coffee to salmon.

This trend has driven increased variety in demand for ingredients. Consumers are more adventurous in what they are willing to try. That used to be more of a restaurant experience and COVID put a halt to demand temporarily. For instance demand for rice bran oil in Asian restaurants in the US was gone for 14 months but now that restaurants have reopened demand has bounced back strongly.

But the regional convergence of diets is more about the regional convergence of supply chains and ingredients rather than the type of food that people are eating. Even if you are in an Asian restaurant or a German restaurant you may be cooking dishes from those cuisines but you are using local ingredients such as your rice bran oil or your sausages. So consumers want to experience global foods but the ingredients are becoming more locally sourced.



Rising middle classes in emerging markets driving agri-flow changes

Another trend shaping the agri-biz supply chain is the explosive growth of the middle class across emerging markets, most notably in Asia. This is driving growth and change in demand patterns across the region. For instance, China has seen a significant increase in protein demand over the last 30 years as a result of rising disposable incomes. Question is what countries are next in line to develop their economies and improve their diets, and will they will follow the same path as China's protein demand?

How will the rise of emerging market middle classes impact agri demand and trade flows?

Not all countries and commodities will benefit from economic growth in the same way as we've seen in China over the past 30 years. The major shift in food demand and commodity prices as a result of growing emerging market economies are more likely in areas such as vegetable oils, proteins and carbohydrates. Fruits and tropical fruits are less likely to be impacted by the continued growth of emerging markets. Some fruit trading, including bananas, pineapples, apples, cherries, etc, are very significant in dollar value but the predominantly focus on developed nations less on the forefront of dietary requirement in emerging markets.

CPG players struggle with innovation models

The trend towards more premium, healthy and locally rooted products requires a level of innovation that many global Consumer Packaged Good (CPG) companies have historically not been strong at as historically they focused mainly on scale, efficiency and price.

But the need to address widespread consumer concerns on the use of palm oil in CPG products started the trend with transparency and traceability. Now, a lot of food companies have started to realise that, from a marketing perspective, there is an opportunity of telling the story of how and where the food is produced, that they are supporting local farmers, etc. This resonates with consumers, especially in developed markets.

But many CPG producers are struggling to respond as much of their focus has been on prices and efficiency. Consumer needs have

evolved but brands struggling to move beyond just making a cheap product and telling consumers that this is what they should be buying. Many CPG's have been caught flat footed by the changing demographics and customer behaviour as can be seen from their declining market shares in recent years against local brands or challenger brands that are more nimble and better attuned to the changing and diverse needs of consumers around the world.

Many CPG's lack strong abilities to innovate internally and instead resort to acquiring companies with innovative brands and capabilities. Also Increasingly, large CPGs are sponsoring incubators who support small entrepreneurs who come up with food innovations that can bring something different to the market.

Supply Side Megatrends and Implications

Besides the above demand side megatrends related to consumer behaviours there are several supply side and trade megatrends that impact the localisation of agri supply chains. These will be discussed in more detail in a subsequent paper and include:

- Covid-19 impact on farming, including more restrictive access to migrant farm workers due to travel restrictions, and supply chains, including increased freight costs
- Industrialisation of farming and genetic innovations is driving crop quality and yield in emerging markets
- Drive towards farming sustainability and traceability
- Potential for farming localisation for intensive farming
- Interplay of local biofuel policies and global vegetable oil supply and pricing
- Increased trade restriction in the form of tariffs and more stringent phytosanitary standards

The impact of these demand supply trends is pushing towards more localisation of agri supply chains. Global commodity flows will likely not be significantly impacted. 85% of the world's palm oil will continue to come from Indonesia and Malaysia and likewise over half of global sunflower oil will come from Russia and Ukraine. This bulk of commodity supply will continue to come from existing locations due to their favourable climate and farming economics.

But consumers around the world are showing much more interest into the origins of products, favouring healthy and sustainable products from local suppliers. The impact on industry stakeholders of such a shift would create significant opportunities and challenges for businesses across the agri value chain and we will discuss these in more detail in subsequent paper.

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Michel Brekelmans is Managing Director at SCP/Asia, a business consulting firm supporting PE/VC investors, portfolio companies and corporate clients across Asia in strategy development and execution, M&A services and performance improvement. Before setting up SCP/Asia, Michel spend 20 years at L.E.K. Consulting based in Singapore and China since 2002. He was a Senior Partner at L.E.K., member of L.E.K.'s Asia Regional Management Committee and led L.E.K.'s offices in Singapore and Greater China. He can be reached at m.brekelmans@scpartnersasia.com.



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