

IMPACT OF GLOBALIZATION ON THE U.S. DAIRY INDUSTRY...*

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OVERVIEW OF COMMENTS

- THE INNOVATION CENTER FOR U.S. DAIRY HAS DEVELOPED AN EXCELLENT REPORT AND GROUP OF RECOMMENDATIONS.
- BUT, A FEW FINDINGS DESERVE ADDITIONAL SCRUTINY.
- ACHIEVING CONSISTENT EXPORTER STATUS
- USEFUL GENERIC EXPORTING STRATEGIES.
- STRATEGY LESSONS FROM FONTERRA, KERRY GROUP, AND NESTLE.

STRENGTHS OF THE REPORT

THE INNOVATION CENTER FOR U.S. DAIRY, WITH ASSISTANCE FROM DAIRY MANAGEMENT INC., USDEC, AND BAIN & COMPANY DEVELOPED IN 2009 ARGUABLY THE MOST COMPREHENSIVE ANALYSIS EVER PRODUCED OF THE GLOBAL ECONOMIC ENVIRONMENT FACING THE U.S. DAIRY INDUSTRY.

STRENGTHS OF THE REPORT (CON'T.)

- THE INNOVATION CENTER IS TO BE COMPLIMENTED FOR OBTAINING INSIGHTS FOR THE REPORT FROM A TASK FORCE OF EXPERIENCED U.S. DAIRY INDUSTRY OFFICIALS.
- IN SUMMARY, THE REPORT SHOULD BE REQUIRED READING FOR PERSONS CONCERNED WITH THE FUTURE OF THE U.S. DAIRY INDUSTRY.

STRENGTHS OF THE REPORT (CON'T)

- BECAUSE OF THE STRENGTHS OF THE REPORT, MY COMMENTS WILL NOT BE THOSE OF A NORMAL CRITIC.
- WHAT DOES A NORMAL CRITIC DO?
“ALL CRITICS DO IS COME OUT OF THE HILLS AFTER THE BATTLE IS OVER AND SHOOT THE WOUNDED.”
--SOURCE: UNKNOWN.

POINTS REQUIRING SCRUTINY (GROWTH MARKETS)

- ASIA, LATIN AMERICA, NORTH AFRICA AND THE MIDDLE EAST ARE DESCRIBED BY THE INNOVATION CENTER AS GROWTH MARKETS.
- THIS DEPICTION OF GROWTH MARKETS MAKES SENSE. THESE MARKETS HAVE HIGH PROJECTED REAL GDP GROWTH.
- HOWEVER, SOME OF THESE MARKETS ARE TOUGH PLACES TO DO BUSINESS. (See Transparency International's CPI FOR 2009)

PROJECTED GDP GROWTH IN SELECTED DAIRY MARKETS

COUNTRY	PROJECTED 2011 REAL GDP GROWTH (%)*
CHINA	9.7%
MEXICO	4.7
ASEAN-5	5.3
MIDDLE EAST	4.8
EURO-AREA	1.6
U.S.	2.4
*Source: IMF	

Country	CPI Score*	Rank Among 180 Countries
China	3.6	79
Indonesia	2.8	111
Malaysia	4.5	56
Mexico	3.3	89
Algeria	2.8	111
Morocco	3.3	89
Saudi Arabia	4.3	63
Bahrain	5.1	46
United States	7.5	19
*0=very corrupt	*10=very clean	

POINTS REQUIRING SCRUTINY (CHINA)

- CHINA HAS EARNED A REPUTATION AS A “WILD WEST” MARKET FOR DAIRY EXPORTS.
- EVIDENCE ON THIS POINT:
 - MAJOR LOSSES BY MANY FOREIGN DAIRY FIRMS IN CHINA IN THE 1990s.
 - CHINA’S MELAMINE SCANDAL IN 2008.
 - FONTERRA OF NEW ZEALAND SUFFERED LOSSES AS A RESULT OF ITS EQUITY INTEREST IN CHINA’S SANLU DAIRY IN 2008.

POINTS REQUIRING SCRUTINY (BRAZIL & UKRAINE)

- BEYOND A 10-15 YEAR WINDOW OF OPPORTUNITY, BRAZIL & UKRAINE MIGHT DELIVER SIGNIFICANT QUANTITIES OF COMPETING DAIRY SUPPLIES ONTO THE GLOBAL MARKET.
- BRAZIL ALMOST CERTAINLY WILL MAKE BIGGER DELIVERIES (AND BEFORE 10-15 YEARS).

POINTS REQUIRING SCRUTINY (UKRAINE)

- UKRAINE IS A QUESTION MARK.
- UKRAINE MIGHT BE LABELED AS “THE COUNTRY OF THE FUTURE AND ALWAYS WILL BE.”
- ABOUT THE UKRAINE: “CORRUPTION IS RIFE, THE COURTS ARE BENT, INSTITUTIONS ARE DYSFUNCTIONAL AND THE ECONOMY IS SICK.”

--The Economist, Dec. 9, 2009

ADDITIONAL SCRUTINY (“WILD CARD” COMMENT)

- THE U.S. DOLLAR WILL APPRECIATE AGAINST THE CURRENCIES OF OTHER KEY DAIRY EXPORTING COUNTRIES:
- MY REACTION IS: “MAKING FORECASTS ABOUT THE UNKNOWABLE IS NOT A GOOD IDEA.” SOVEREIGN DEBT PROBLEMS IN THE EU COMPLICATE THE SITUATION.
- BUT IT WILL BE TOUGH FOR THE U.S.DOLLAR TO APPRECIATE GIVEN THE PROSPECTIVE U.S. CURRENT ACCOUNT DEFICITS (4 TO 5 % OF GDP IN 2011-2014).

ACHIEVING CONSISTENT EXPORTER STATUS

- REFORM REGULATED MILK PRICING SYSTEM AND PRICE SUPPORTS:
- GOOD IDEA BUT TOUGH TO DO.
- A DAIRY INDUSTRY RIP VAN WINKLE WHO FELL ASLEEP IN 1950 AND AWAKENED TODAY WOULD HAVE NO TROUBLE RECOGNIZING THE CURRENT FMMOs AND USDA DAIRY PRICE SUPPORT PROGRAM.

ACHIEVING CONSISTENT EXPORTER STATUS (CON'T)

- PURSUE TRADE TREATIES THAT PROVIDE NET EXPORT BENEFITS:
- GOOD IDEA BUT TOUGH TO DO.
- WTO DOHA ROUND MINISTERIALS, MINI-MINISTERIALS, AND SUMMITS (7 IN ALL) HAVE ENDED IN COLLAPSE OR STALEMATE.
- THE OBAMA ADMINISTRATION HAS FEW INCENTIVES TO PUSH FOR TRADE REFORM.

ACHIEVING CONSISTENT EXPORTER STATUS (CON'T)

- BUILD ON EXISTING FOOD SAFETY ASSURANCES AND TRACEABILITY AS A COMPETITIVE STRENGTH:
- GOOD IDEA FOR NUMEROUS REASONS. CHINA'S MELAMINE SCANDAL SHOWS WHAT HAPPENS IF FOOD SAFETY IS NEGLECTED.
- CHINA'S MELAMINE SCANDAL SOLIDIFIED CHINA'S REPUTATION AS A "WILD WEST" MARKET FOR DAIRY EXPORTS.

POTENTIALLY USEFUL GENERIC STRATEGIES

- BENCHMARK AGAINST THE BEST IN THE WORLD.
- COMMODITY EXPORTERS MUST BE LOW-COST PRODUCERS TO REMAIN PROFITABLE OVER THE LONGER-RUN.
- SELLERS OF DIFFERENTIATED (VALUE-ADDED) PRODUCTS NEED NOT BE LOW-COST PRODUCERS. SELLERS OF DIFFERENTIATED ITEMS CANNOT IGNORE COSTS BUT COSTS ARE NOT THE BIGGEST COMPETITIVE ISSUE.

POTENTIALLY USEFUL GENERIC STRATEGIES (CON'T)

- BEING A LOW-COST PRODUCER OF A DIFFERENTIATED PRODUCT YIELDS ADDITIVE BENEFITS.
- AVOID BEING “STUCK IN THE MIDDLE.”
- AVOID DEFINING YOUR BUSINESS TOO NARROWLY.
- KEEP IN MIND EARLY-MOVER ADVANTAGES.

RATIONALE FOR EARLY-MOVER STRATEGY

“INITIAL ENTRANTS INTO A MARKET GAIN, ON AVERAGE, A 15 PERCENT ADVANTAGE OVER SECOND ENTRANTS. THIRD PLACE ENTRANTS INTO A GIVEN MARKET TEND TO BREAK EVEN. ENTERING A MARKET LATER IS A STRATEGY FOR LOSING MONEY.”

--Neville Martin, New Zealand Dairy Board, 1995.

STRATEGY LESSONS FROM FONTERRA, KERRY & NESTLE?

- WHY TAKE LESSONS FROM THESE FIRMS?
- THEY ARE ARGUABLY AMONG THE BEST IN THE WORLD.
- THEY ARE GLOBAL DAIRY PLAYERS.
- ALL THREE HAVE ADJUSTED EFFECTIVELY TO THE ECONOMIC ENVIRONMENT THEY FACE, WHICH IS THE ESSENCE OF STRATEGY.

STRATEGY LESSONS FROM FONTERRA OF NEW ZEALAND

- DEVELOP MAJOR SCALE ECONOMIES IN MILK PROCESSING.
- ACHIEVE ADDITIVE BENEFITS OF LOW COST PRODUCTION AND PRODUCT DIFFERENTIATION.
- SOURCE PRODUCT FROM MULTIPLE COUNTRY LOCATIONS.
- DEVELOP PROFICIENCY FOR SERVING BIG, “WILD WEST” MARKETS.

STRATEGY LESSONS FROM KERRY GROUP OF IRELAND

- ADJUST TO POLICY ENVIRONMENT.
- RAISE CAPITAL BY CONVERTING A COOP INTO A PLC.
- EXPAND PRODUCT DIFFERENTIATION.
- DEVELOP SOPHISTICATED R&D.
- DEFINE THE FIRM BROADLY—NOT JUST AS A DAIRY COMPANY.
- MAINTAIN MANAGEMENT CONTINUITY.

STRATEGY LESSONS FROM NESTLE OF SWITZERLAND

- FOCUS ON LONG-RUN.
- BALANCE SALES BETWEEN LOW-RISK, LOW-GROWTH COUNTRIES AND HIGH-RISK, HIGH-GROWTH COUNTRIES OF ASIA, LATIN AMERICA, AND AFRICA.
- DEVELOP SOPHISTICATED R&D.
- ENGAGE IN CONTINUOUS IMPROVEMENT AND NEARLY CONSTANT COST CUTTING.
- EMPLOY “MILK DISTRICT” SYSTEM.

STRATEGY LESSONS FROM NESTLE (CON'T)

“IN SPITE OF FREE MARKET REFORMS, CHINA (CONTINUES TO BE) A DIFFICULT AND UNCERTAIN PLACE TO DO BUSINESS. YET EVEN WITH THE RISKS, THE POTENTIAL GAINS ARE SO GREAT THAT NO MAJOR FOOD COMPANY CAN AFFORD **NOT** TO ENTER THE MARKET.”

--Helmet Maucher, former CEO of Nestle, 1996.