A systematic analysis of the agribusiness sector in transition economies:

The Romanian dairy sector
ACKNOWLEDGEMENTS

This study was commissioned by the European Bank for Reconstruction and Development (EBRD) jointly with the Investment Centre of the Food and Agriculture Organization of the United Nations (FAO), under the co-operation agreement between the two institutions. The lead consultant and main author of the report was Liesbeth Dries, currently Assistant Professor Institutional Economics, Agricultural Economics and Rural Policy Group, Wageningen University, The Netherlands. The EBRD team was led by Heike Harmgart, Principal Economist in the Office of the Chief Economist in close collaboration with the Agribusiness banking team of the EBRD under the directorship of Gilles Mettet. The FAO team was led by Emmanuel Hidier, Senior Economist; and team members D’mitry Prikhodko, Agricultural Economist, on whose background research a substantial part of this analysis is based, and Nada Zvekic, Communications Officer at the FAO. The report benefited further from discussions with Marc von Strydonck, Senior Banker, Vedrana Jelusic, Senior Banker and Miljan Zdrale, Principal Banker at the Agribusiness team of the EBRD. Special thanks to Kerstin Meins, analyst at the Office of the Chief Economist for her editing and layout assistance. The EBRD team would like to extend its warm thanks for the kind assistance received from all the government and private sector representatives who kindly shared time with the team, in particular the Animal Production Department in the Ministry of Agriculture; National Agency for Reproduction and Improvement in Animal Production; the National Authority for Sanitary and Veterinary Affairs and for Food Safety; Representatives at USDA; Agroindustriala Pantelimon; Danone AD; InterAgro; Macromex; Effi; Mega Image; Billa Romania and Minimax Discount.
Executive Summary

This analysis of the Romanian dairy sector follows the structure of the local dairy value chain and the EBRD transition assessment indicators of the extent and structure of markets, policies and institutions, and business conduct. It supplements information from secondary sources with qualitative interviews conducted in Romania in July 2007 and draws upon views and insights contributed by government agencies, related institutions and interest groups, milk producers, dairy processors, wholesalers and retail businesses. It identifies remaining transition challenges and follows them up with suggestions as to how they can be overcome.

Since Romania’s accession to the EU in January 2007, the main policies and institutions relevant to the dairy sector are derived from EU regulations on the common market organisation for milk and milk products, and on the hygiene of foodstuffs and food of animal origin. The first set of regulations comprises three groups of measures: Market stabilisation and price support; direct support payments to farmers that cover losses caused by decreases in intervention prices; and a milk quota system to control supply. In terms of market policies, the quota system is perceived to be the most limiting to growth and development in the dairy sector. Regarding food quality and hygiene provisions, the dairy sector mainly struggles with requirements for the quality of raw milk. Romania was granted a grace period until the end of 2009 during which raw milk that itself is either non-compliant with EU standards or stems from non-compliant farms can still be delivered to certain [domestic] processors. Come 2010, however, sub-standard milk will not even be purchased or traded domestically any more so that its only possible use will be on-farm consumption.

The challenges to the Romanian dairy sector are manifold: Milk yields are low compared to other EU countries and the 2007 average price of milk was the lowest in the EU (however, it also increased at the fastest rate). Milk production is further affected by a high degree of seasonality that causes price fluctuations on the raw product and retail markets, and there is a large gap between milk prices paid by processors at the farm gate and prices achieved by producers through on-the-spot direct sales to consumers. Farmers’ organisations are largely ineffective and producers thus inhabit a chronically weak negotiating position relative to producers who own the majority of milk collection centres recognised by the National Veterinary and Animal Health Agency. In order to become more independent, groups of producers have begun to set up private collection centres, but there are still few of them.

The Romanian dairy farm sector is characterised by a high degree of fragmentation and a large number of subsistence or semi-subsistence farms: More than 93% of all farms have only one or two cows and only a small share of total milk production (22%) is delivered to dairy processing companies. Many of the challenges to the sector are directly linked to the small scale of farming operations. Essential in facing them are investments in milking and cold storage equipment, improvements in feed and forage practices, the introduction of specialised dairy breeds, and advanced techniques for animal husbandry. Government programs and private initiatives by dairy processing companies have been established to upgrade producers so their operations will be viable. However, such upgrades are unlikely or even impossible to be realised on many small-scale farms. Dairy producers have already begun to turn away from small collection centres which collect from mostly small farms that are unlikely to become compliant with EU standards by 2010 while remaining profitable. Such farms have already begun to close down, presumably in anticipation of this development. Medium- to large-scale farms appear to be the future of Romanian dairy.
The production level is furthermore affected by insufficient capacities at governmental milk quality control laboratories, a problem that could be solved if milk quality control were to be privatised. Also, it seems that [farm]land is getting increasingly difficult to come by and to retain in the sense that real estate development and environmental standards have begun to ‘squeeze out’ agriculture in many places. Lastly, high incidences of theft often force farms to allocate parts of their resources to the protection of their property and assets rather than to production itself.

Since EU accession, Romanian dairy processing is governed by hygiene standards for dairy processing companies set by several EU regulations. Processors are required to operate food safety programmes and procedures based on HACCP\(^1\) principles. Several provisions that concern dairy processors specifically deal with requirements regarding milk temperature, heat treatment, plate counts, and packaging and labelling. A main challenge on the processing level clearly is to secure sufficient amounts of EU-quality standard milk in the coming years. As of October 2006, the majority of Romanian processing establishments was either compliant with EU regulations and thus certified to export to the EU, or expected to become compliant by the time of accession. A sizeable minority of processors were allowed a grace period during which their products were to be labelled in a specific way to signify their unsuitability for EU-trade, while a small number of processors was to be shut down come January 2007.

The number of dairy processing companies in the market has decreased in recent years, but still processors with capacities of all scales remain. Competition between numerous strong players in the market for milk deliveries is rather limited, presumably due to the geographic separation of individual, regionally dominant processors’ milk-sourcing areas. Also, dominant processors seem to be able to bind medium- to large-scale producers of high-quality milk through consistency in payments and assistance programmes.

Investment in dairy processing have been high in recent years, with the largest share (70% of investments) being accounted for by resources from within the dairy industry. Numerous big dairy companies have been actively involved in upgrading the level and quality of milk production through support schemes. For instance, an important role is played by milk price incentive schemes within the scope of which processors ‘pay for quality’. According to experts, not least through such initiatives the quality of raw milk has improved recently; between 30% and 45% of all milk delivered to processing companies is now compliant with EU standards. There is evidence of vertical integration between processors and dairy farms, but it is unclear whether stricter quality and hygiene standards or other recent developments are stimulating the integration process.

Dairy imports from other EU member states increased rapidly following EU accession, and next to perceived ‘better’ quality, range and presentation of imported dairy products, Romania’s status as a net-importer of milk and dairy products appears to be owed to inefficient dairy production: Collection and processing costs are high and will need to be brought down as to not further weaken the country’s competitive position.

In the Romanian retail sector, as can also be observed in other CEE countries, foreign-owned retail chains dominate the market. Concentration is still low, however – none of the international chains has reached a double-digit market share yet, the top-5 retailers hold only

---

1 HACCP = Hazard Analysis and Critical Control Points
21% of the market, and the market leader secures a mere 7%. The market share of large-scale retail has increased from 23% to 33% between 2004 and 2006, but it is still low when compared to other EU countries. The sector is still in its infancy, but large-scale retail is expected to gain 50% of total retail sales by 2010, which puts development forecasts for Romanian large-scale retail at a rate above both EU and regional averages. Interest in the large-scale retail sector is developing rapidly, with major investments (and plans) by many of the international chains. In theory, foreign investment in Romania is easily possible, but in practice a major challenge to the sector is posed by a high degree of bureaucracy that often seriously hampers the process of setting up a business.

Presently, most retailers still sell products labelled for EU trade and those suitable only for the domestic market. However, some high-end supermarkets are already offering exclusively EU-standard dairy products, which shows that sales opportunities for local dairies currently benefiting from the grace period are already limited to retail channels with less stringent quality policies. Competition between traditional small-scale and modern large-scale retailers remains strong, especially where food products are concerned. Loyalty to traditional retail channels may be due to tradition, perceptions of quality and freshness or for lack of access to large-scale retailers, e.g. in rural areas. Nonetheless, features of the modern retail sector are beginning to be introduced in Romania, e.g. retail chains have begun to develop private labels for the main food and beverage categories, which since EU accession are sourced increasingly from abroad. Also, some supermarkets and hypermarkets are developing their own logistical centres, which in turn begin to limit the role played by wholesalers that are still important for small-scale retail outlets, but among which market concentration is expected to take place in the medium to long run.

Among the main challenges to the retail (and wholesale) sector are the low purchasing power among consumers, transport issues and the limited availability of building plots in Bucharest, and underdeveloped mechanisms and infrastructure for the distribution of chilled products.

Measures suitable to address the transition challenges present in Romania’s dairy sector vary depending on supply chain level and the specificities of the challenge. Some require solutions on the EU or national policy level, others can be met through capacity building and yet others necessitate public and/or private investment.

Primary production:

- Initiate capacity building measures (education, training) for farmers to improve milk yield and quality
- Review and possible revision of EU-policy level milk quota regulations to support sector development
- Request extension of milk-quality grace period
- Devise suitable social policy to counteract social effects of ongoing/impending structural change on the production level
- Improve access to investment finance through suitable policy and public investment, devote more attention to medium-size farming operations

Processing:
• Limits on high quality milk supply require the abovementioned measures to be taken; additionally, processors should be educated on possibilities offered by alternative raw milk sources and product development
• Raise awareness of existing divide between two types of dairy producers (larger-scale higher-quality / smaller-scale lower-quality) that are unlikely to benefit equally from certain types of policy
• Largely inevitable increases in dairy product prices require improvements in supply chain efficiency, especially through farm-level consolidation; to be achieved through [processors’] private investment, e.g. in animal stocks, that work to lower collection and transportation costs
• Privatisation of milk quality control laboratories to remove capacity bottlenecks at government-run laboratories
• Involve key stakeholders from the dairy sector in the development of legislation and policies that concern this sector to counteract deteriorating levels of transparency at the government level

Retail and distribution:

• Deregulate to simplify procedures for business start-up and development, decrease the level of bureaucracy, counteract existing bribery practices
• Increase investment in the cold chain in order to overcome the present state of infrastructural underdevelopment regarding the distribution of chilled products
• Congestion problems in and around Bucharest require public policy to pay more attention to the development of sustainable city planning and solutions to major traffic bottlenecks
1. Introduction

The report will be organised based on the structure of the dairy value chain (Table 1) and the EBRD transition assessment indicators of the extent and structure of markets, policies and institutions, and business conduct.

Table 1. The Dairy Value Chain

<table>
<thead>
<tr>
<th>Value chain segments</th>
<th>Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Primary production</strong>&lt;br&gt;[Milk wholesale – milk trade]</td>
<td>Milk production</td>
</tr>
<tr>
<td><strong>Processing</strong></td>
<td>Milk processing; Processed milk production (fresh / long shelf life); cheese, yoghurt; ice cream; butter; powdered milk; …</td>
</tr>
<tr>
<td>[Logistics – dairy product wholesale trade]</td>
<td>Open market sales&lt;br&gt;Small-scale retail trade&lt;br&gt;Large-scale retail trade</td>
</tr>
</tbody>
</table>

Information gathered from secondary sources (including data gathered by FAO) was complemented by qualitative interviews conducted in Romania in the period 23-27 July 2007. The following companies and institutions have contributed to this report by sharing their views and insights:

(1) Government agencies, related institutions and interest groups:
   - Ministry of Agriculture – Animal Production Department
   - National Agency for Reproduction and Improvement in Animal Production
   - National Authority for Sanitary and Veterinary Affairs and for Food Safety
   - USDA

(2) Milk producer:
   - Agroindustriala Pantelimon

(3) Dairy processors:
   - Danone AD
   - InterAgro

(4) Wholesale activity:
   - Macromex
   - Effi

(5) Retail business:
   - Mega Image
   - Billa Romania
   - Minimax Discount
2. Primary production

2.1. Structure and extent of markets

Table 2 gives an indication of the structure of the dairy farm sector in 2001 and 2006. The most striking feature of the dairy sector is its high degree of fragmentation. The figures show that by 2006, 93% of dairy farms have only 1-2 cows and that 76% of the total cow herd is based on these farms. Although the share of such small-scale farms in total was even higher five years earlier (95% of total farms in 2001), their prominence in the farming structure remains. Only 0.5% of farms have a herd size of more than 10 cows, while 8.5% of all cows in Romania are held on these farms. The fragmentation of the dairy sector, and the dominance of 1-2 cow farms specifically, is stronger in Romania than in any other EU member state. For instance, in Bulgaria, only 45% of cows are held on 1-2 cow farms. In Poland, this share is even lower than 30%. (CEEC AGRI POLICY – FP6 project report and IERiGZ)

In terms of dynamics, between 2001 and 2006 we observe a decline in the group of smallest producers (1-2 cows per farm), while especially the medium sized farms (10-30 cows per farm) are growing in importance. This pattern is seen even more clearly when looking at the cow distribution over different farm size groups. Between 2001 and 2006, the total cow herd in Romania has remained more or less constant. However, the total number of cows held on farms with only 1-2 cows has decreased by around 130,000 head in favour of cow herd growth on medium to large farms. Again we notice the sharp growth in animal numbers in farms holding 10-30 cows on average. The relatively lower cow herd growth in farms with over 30 cows can be explained by the decline in farms with more than 100 cows in favour of more medium-sized farms in this size group.

Table 2. Dairy farm distribution based on cow herd size, 2001-2006

<table>
<thead>
<tr>
<th>Herd</th>
<th>Farms</th>
<th>Cows</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td># (in 000)</td>
<td>%</td>
</tr>
<tr>
<td>1-2</td>
<td>1,134</td>
<td>1,030</td>
</tr>
<tr>
<td>3-5</td>
<td>47.7</td>
<td>63.1</td>
</tr>
<tr>
<td>6-10</td>
<td>4.3</td>
<td>8.0</td>
</tr>
<tr>
<td>11-15</td>
<td>1.0</td>
<td>2.3</td>
</tr>
<tr>
<td>16-20</td>
<td>0.4</td>
<td>1.2</td>
</tr>
<tr>
<td>21-30</td>
<td>0.3</td>
<td>0.7</td>
</tr>
<tr>
<td>&gt; 30</td>
<td>0.5</td>
<td>0.8</td>
</tr>
<tr>
<td>Total</td>
<td>1,188</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Van Berkum (2007); CEEC AGRI POLICY FP6 project report (2006)

Due to the highly fragmented farming structure, an important share of dairy farms can be classified as either subsistence or semi-substitution farms. According to the 2002 General

---

2 For comparison, Annex 1 provides information on the structure of the Portuguese dairy sector.
Agricultural Census, about 30% of milk producers sell raw milk, and about 5% of milk producers sell dairy products. About 70% of dairy farms are subsistence farms, producing only for their own consumption, and about 25% are semi-subsistence farms, commercialising less than 50% of their production. Hence, less than 5% of dairy farms can be considered as commercial farms – producing mainly to sell. This situation has changed little since 2002. (CEEC AGRI POLICY FP6 project report)

As a result, only a small share of total milk production is sold to processing companies. In 2006, only 22% of total milk production were delivered to dairy companies. About 28% of milk was going through the direct sales channel either as raw milk or in the form of basic dairy products that are produced on-farm, such as cream, cheese and white yoghurt. Direct sales to final consumers are especially important in the rural areas. The remaining 50% of milk are used for self-consumption on the farm (about 40%) and as feed for farm animals (10%). (USDA, 2007) Compared to other new EU member states, the share of processed milk is extremely low in Romania. For example, in Bulgaria, 62% of total milk are processed, in Poland the share of delivered milk in total is 76%. (USDA (2006c) and IERiGZ)

2.2. Market institutions and policies

Since January 2007, the Romanian dairy market is organised under the Common Market Organization for milk and derived dairy products as part of the EU Common Agricultural Policy. The basic regulation establishing the Common Market Organization for milk and milk products dates back to 1968 (Reg. EEC 804/68). The support system comprises three groups of measures.

The first group consists of market support measures, which intend to stabilize the market and support internal prices. This group includes: measures stimulating demand (special disposal measures for butter, milk powder, cream), measures stabilizing the market (market intervention for butter and skimmed milk powder, private storage system) and international trade control measures (border protection and export subsidies). The second group of measures includes direct payments, introduced in 1992, which directly support farmers’ incomes by covering the losses caused by decreases in intervention prices.

The third group of measures consists of supply control regulations, i.e. a milk quota system. The main purpose of the milk quota system was to restrict milk production to limit market support to certain quantities of milk. The central element of the system is the referenced quantity of milk and milk products that can be delivered yearly to the market in each particular country. As a result, each producer in each country has an individual referenced quantity for deliveries to processing (‘Deliveries’ quota) and/or for direct sales to consumers (‘Direct sales’ quota), which should not be exceeded. When total production is above the national quota, every farmer that contributed to this excess has to pay the super-levy. Important to note is that each individual quota consists of a referenced volume of milk at a certain fat content (3.91%). Therefore, when milk deliveries contain higher fat content than referenced, the total quota will be filled more rapidly. Quota can be traded within a particular country but not internationally. Possibilities of quota transfers and their administrative restrictions are important for the structural development of milk production. The more restricted are the milk quota transfers, the less stimulating effects there are for the concentration process and structural changes (Oskam and Speijers, 1992).
The total milk quota for Romania is 3,057,000 tons of milk per year, of which 1,093,000 tons are for deliveries and 1,964,000 are for direct sales. According to the Ministry of Agriculture, about 720,000 producers have been granted milk quota. 650,000 producers have received direct sales quota, 250,000 producers have deliveries quota (some producers have requested and received both direct sales and deliveries quota). About 188,000 tons are assigned to the national reserve. This quota reserve can be released in 2009 if it becomes clear that the rate of self-consumption of milk has decreased significantly and hence, there is a need for more marketed milk.

Since the Romanian quota is well below total Romanian milk production, the distribution of quota to individual farmers had to be restricted. The penalisation of farms – in the sense that lower quota would be granted than requested – was implemented only with respect to the direct sales quota. This means that farms requesting deliveries quota (in general, this group includes the largest farms), were granted the amount of quota that they requested. On the other hand, farms requesting direct sales quota would receive 11% less quota than their initial request.

There are a number of criticisms of the quota system in Romania. First, the quota assigned to direct sales is almost twice as high as the deliveries quota – which is considered to institutionalise a distorted situation (namely, the extent of the grey market for dairy products). Industry analysts believe that by 2008, the amount of milk processed domestically will double, reaching 2 million ton, in parallel with an equivalent reduction in direct sales of milk and dairy products. Furthermore, it is expected that a growth in purchasing power will trigger an annual 2-3% increase in the dairy product market. The shrinking of the grey and black markets is estimated to result in a 10-15% growth of demand for dairy products. (USDA, 2006b)

The second criticism is related to this point. The total quota allowance for Romania is much lower than actual milk production in Romania, which could seriously hamper the further development of the dairy sector. For example, a considerable decrease in self-consumption of milk in rural areas cannot be substituted by an equivalent increase in processed dairy products sales because of the limiting quota system. Table 3 gives an overview of the milk quota assigned to the different CEE countries that have joined the EU since May 2004.
Table 3. Milk quota per country, in 000 ton

<table>
<thead>
<tr>
<th></th>
<th>Milk production '01</th>
<th>Milk quota assigned</th>
<th>Quota as share of total prod.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>Delivered</td>
<td>Total</td>
</tr>
<tr>
<td>Poland</td>
<td>12.030</td>
<td>7.037</td>
<td>9.380</td>
</tr>
<tr>
<td>Romania</td>
<td>5.300</td>
<td>1.200</td>
<td>3.245</td>
</tr>
<tr>
<td>Czech R.</td>
<td>2.702</td>
<td>2.512</td>
<td>2.738</td>
</tr>
<tr>
<td>Hungary</td>
<td>2.100</td>
<td>1.726</td>
<td>1.990</td>
</tr>
<tr>
<td>Lithuania</td>
<td>1.730</td>
<td>1.153</td>
<td>1.705</td>
</tr>
<tr>
<td>Slovakia</td>
<td>1.114</td>
<td>930</td>
<td>1.040</td>
</tr>
<tr>
<td>Latvia</td>
<td>848</td>
<td>403</td>
<td>728</td>
</tr>
<tr>
<td>Estonia</td>
<td>687</td>
<td>460</td>
<td>646</td>
</tr>
<tr>
<td>Slovenia</td>
<td>660</td>
<td>461</td>
<td>576</td>
</tr>
</tbody>
</table>

Source: Danone Romania (2007)

A third criticism is of the establishment of seven quota regions. Quota volumes are fixed within each of these regions and the trade of quota between regions is not allowed. Although it is too early to observe the limiting effect of this regional allocation on the ground, it can be expected that this system will hamper the restructuring process in the medium to long run. One of the reasons for this is that it is likely that there are some regions that are more suitable for dairy production than others and that these regions will harbour the fastest growing dairy farms. However, it will be relatively more difficult for farmers to get access to additional quota in regions where all of their neighbours are evenly eager to extend their business than for farmers in ‘sleeping regions’. As such, overall farm growth and restructuring will be slowed down by the restrictive nature of a regional quota system.

The restructuring process is furthermore hampered by the fact that selling quota is not costless. Milk quota can be traded freely. However, for every trade that is being made, 30% of the traded volume in quota has to be transferred to the national reserve. This may act as a disincentive for farmers contemplating the sale of their quota as it will lower the total value of their quota endowment.


The basis for Regulation 852/2004 is the implementation of HACCP principles at the level of each operator in the food chain. However, it is recognised that the application of HACCP principles to primary production is not yet generally feasible. Instead, guides to good practice should encourage the use of appropriate hygiene practices at the farm level. Furthermore, Regulation 852/2004 is not applicable in the case of the direct supply of small quantities of primary products, by the food business operator producing them, to the final consumer or to a local retail establishment. Such cases should be regulated by national law. Other activities that are exempt from the rules in this Regulation are primary production for private domestic use and domestic preparation for private use only. Regulation 852/2004 also allows for flexibility.

---

3 HACCP = Hazard Analysis and Critical Control Points
in regions that are subject to special geographical constraints and in the production, processing, and distribution of food prepared using traditional methods, without compromising food hygiene objectives. The main provisions in Regulation 852/2004 that are relevant to operators in the dairy sector include: (1) maintaining the cold chain for all food that cannot be stored safely at ambient temperatures; (2) compliance with microbiological criteria for foodstuffs; (3) compliance with temperature control requirements; (4) sampling and analysis; (5) record-keeping (nature and origin of animal feed, veterinary medicinal products, analyses results, etc.); (6) layout, design, construction, etc. of food premises; (7) transport of foodstuffs.

Regulation 853/2004 lays down specific hygiene rules for food of animal origin. Again, this Regulation does not apply to primary production (or preparation) for private domestic use, and in cases where small quantities of primary products are supplied directly to end consumers or to a local retail establishment, public health should be protected by national law. Flexibility is appropriate to enable the continued use of traditional methods and for regions that are subject to special geographical constraints. The provisions in Regulation 853/2004 cover requirements for raw milk at the primary production level, requirements for dairy products, and requirements with respect to the packaging and labelling of dairy products. Requirements for raw milk include provisions about the health of animals that produce the milk; hygiene on milk production holdings (premises and equipment, hygiene during milking, collection and transport, as well as staff hygiene), and criteria for raw milk. Some of the most critical (in the sense that they are most difficult for small farmers to comply with) requirements include: Premises for storage of milk must have adequate separation from premises where animals are housed and must have suitable refrigeration equipment; immediately after milking, milk must be held in a clean place designed and equipped to avoid contamination. It must be cooled immediately to no more than 8°C in the case of daily collection or no more than 6°C if collection is not daily; during transport, the cold chain must be maintained, and, on arrival at the establishment of destination, the temperature of the milk must not be more than 10°C. These temperature requirements are not compulsory in case the milk is processed within two hours after milking or when a higher temperature is required in a specific production technique; finally, raw milk must meet the following criteria (based on a geometric average of at least two samples per month over a two month period): plate count (germ count) should be below 100,000 per ml; somatic cell count should be below 400,000 per ml.4

In terms of quality policy, Romania was granted a grace period of milk quality standards until the end of 2009. Starting January 2010, milk which does not meet the standard EU requirements will not be purchased and traded and can be consumed only on-farm. Producers of sub-standard milk will have the right to sell their milk quota or switch to on-farm consumption only. During the grace period, non-compliant raw milk and raw milk from non-compliant farms can be delivered only to dairy processors that benefit from the transitional period. (USDA, 2006b)

The national support scheme includes a number of measures to tackle some of the most prevailing weaknesses in the sector: subsidies for the improvement of the genetic base; premiums to stimulate improvements in the quality of raw milk (based on germ and somatic cell counts) and premiums to increase the quantities of raw milk being delivered to the processing units.5 Furthermore, there is government support available for investments. A

---

4 For raw milk from other species than cows, the plate count should not exceed 1,500,000 germs per ml.
5 Annex II illustrates in more detail the different support policies that applied to the dairy sector in 2006.
programme that ran from 2005 to 2006 helped private milk producers to buy new milking, cooling, and other essential equipment. This programme consisted of a grant equivalent to 60% of the price of the equipment. (CEEC AGRI POLICY FP6 project report)

The Romanian Development Bank introduced a product especially for milk producers. It offers medium-term (up to five years) investment loans for cow milk producers who have a delivery contract with one of the main dairy processing companies. The credit can be used for purchase of cows, equipment, for building and other on-farm improvements, and for buying land. (CEEC AGRI POLICY FP6 project report)

‘The Farmer’ governmental programme, created to stimulate investments in agriculture and the food industry to accelerate the use of SAPARD funds, is a source of investment loans with a low interest rate (5%) that both milk producers and processors can use. Furthermore, the Apuseni Mountains Rural Development Project is designed especially for farmers and processors located in the Apuseni mountains. (CEEC AGRI POLICY FP6 project report)

With EU accession, Romania’s rural areas can become beneficiaries of a number of EU funding sources. A first source of funds comes through the structural and cohesion funds (SCF), meant to alleviate disparities between EU regions. For Romania, the total SCF package for 2007-2013 amounts to 19.7 billion Euro, under three components: the Regional Development European Fund, the Social European Fund and the Cohesion Fund. Funding may cover up to 85% of total project cost with the balance coming from the national budget. Various regions in Romania easily qualify for finance under the Cohesion Fund. (USDA, 2007)

In addition to structural funds, there are two funds related to the common agricultural policy: the European Agricultural Guarantee Fund (financing market measures) and the European Agricultural Fund for Rural Development. The budgetary allocation for Romania under these two types of assistance totals 12.3 billion Euro for the period 2007-2013. This funding will cover direct payments to farmers (5 billion Euro) as well as investment projects in agriculture and rural development (7.3 billion Euro). (USDA, 2007)

The 7.3 billion Euro allocated to rural development will be used for investment projects under different priority axes. Axis 1 groups measures that are aimed at improving the competitiveness of the agriculture and forestry sector, such as investments for modernising agricultural holdings and investments for setting up processing units. It is important to note that only part of the project costs under these measures can be supported. As a result, a significant share of the investment costs will have to be borne by the applicant. Axis 2 includes measures to improve the environment and the countryside. Axis 3 deals with support for improving the quality of life in rural areas (support for developing micro-enterprises, investments in agro-tourism, etc.). (USDA, 2007)

In terms of direct payments to farmers, Romania opted for the Single Area Payment Scheme (SAPS) and the minimum eligible farm size was set at 1 ha. SAPS provides farmers with a uniform per-ha lump sum, payable once a year, regardless of the crops planted and regardless of whether cultivated or not (as long as the land is kept in good agricultural condition). This per ha payment is estimated to be 50 Euro/ha. Furthermore, on top of the general direct payments, the dairy sector will benefit from dairy premia. The amounts of these premia are

---

6 In fact, 8.022 billion Euro was allocated to the EFARD funds but part of this amount will be used for direct payment top-ups.
related to the quota and will start at 24.94 Euro per ton in 2006/7. Additional premia will be granted per area of permanent pasture. (USDA, 2007)

2.3. Business conduct and skills

Hygiene is a problem because many small producers cannot achieve the required standards as most of them do not have milking and cooling equipment. This is not a problem on large farms. Expert opinion is that the quality of raw milk has improved since 2004. The stimulus for this improvement has been the introduction of payment for quality (fat content, germ and somatic cell counts) by processors. (CEEC AGRI POLICY FP6 project report) Experts estimate that between 30% and 45% of the milk that is delivered to processors complies with EU milk quality standards.

Apart from quality problems due to the lack of milking and cold storage infrastructure, the raw material flow is strongly affected by seasonality. (USDA, 2006b) This seasonality is not limited to the primary production stage. The shortage of milk in winter results in a shortage of dairy products (and hence higher prices) on the retail market as well.

Farm gate prices are low and small farmers especially prefer to sell their milk directly to consumers. Not only do they receive significantly higher prices in this way, but they are also paid on the spot with none of the delays which frequently occur when delivering to processors. Farmers are in a weak negotiating position relative to processors because of the large number of producers and the ineffectiveness of their associations. Furthermore, most of the collection stations are owned by the processors. (CEEC AGRI POLICY FP6 project report) Figure 1 shows the gap between farm gate milk prices and the price of milk on peasant markets. Table 4 relates farm gate milk prices in Romania to some other EU countries. The figures show that milk prices are the lowest in Romania compared to other EU countries but that prices are increasing more rapidly than anywhere else.
Figure 1.
Average prices of milk at the farm gate and on peasant markets in Romania, 2000-2005.

Average prices of milk

![Graph showing average prices of milk from 2000 to 2005]

Source: CEEC AGRI POLICY FP6 project report

Table 4. Farm gate milk prices in € per 100 kg in the first eight months of 2007

<table>
<thead>
<tr>
<th>Country (region)</th>
<th>Average price 2007</th>
<th>Change from 2006 in %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bavaria (Germany)</td>
<td>31.05</td>
<td>+ 12.82</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>22.41</td>
<td>+ 6.55</td>
</tr>
<tr>
<td>Poland</td>
<td>27.20</td>
<td>+ 6.97</td>
</tr>
<tr>
<td>Slovakia</td>
<td>27.92</td>
<td>+ 10.51</td>
</tr>
<tr>
<td>Romania</td>
<td>22.31</td>
<td>+ 17.30</td>
</tr>
</tbody>
</table>

Source: CLAL (2007)

Milk prices follow a seasonal pattern, in line with the seasonality of production (high production and low prices in summer, and low production and high prices in winter). However, since 2006 milk prices have continued to rise throughout the summer period as processors were making efforts to identify and secure new sources of milk supply. The additional costs (related to difficult collection and poor transport infrastructure) borne by the processing industry are high so that the gap between farm gate prices for milk and retail prices has diminished recently. (USDA, 2006b)
Milk yields are low (3565 kg per cow per year) due to the low genetic quality of the dairy livestock and poor housing conditions of the animals. (CEEC AGRI POLICY FP6 project report and FAOSTAT) In comparison, milk yields are 4336 kg per cow per year in Poland and 6548 kg per cow per year in France.

2.4. Remaining transition challenges

Many of the challenges faced by the Romanian dairy sector – such as low milk quality, low average yields and a high degree of seasonality – are linked to the small scale of farming operations. Investments in milking and cold storage equipment, improvements in feed and forage practices, introduction of specialised dairy breeds, and advanced techniques for animal husbandry are essential in facing this challenge. However, such investments and improvements are unlikely, or even impossible on the small-scale dairy farms that dominate the Romanian dairy sector.

Both government programs and private initiatives by dairy processing companies have been established to upgrade milk producers (also the small ones) and to make their operations viable. These efforts have resulted in the establishment and upgrading of medium- to large-scale dairy farms in recent years and these farms will be the future of the Romanian dairy sector. The issue that remains is that of the collection centres. At this moment, a large part of the milk collected by dairy companies in Romania goes through the system of milk collection centres, to which many small farms deliver a small quantity of milk each. These collection centres are unlikely to become compliant with EU food quality and hygiene regulations before the end of the grace period. As a result, dairy processors are driven to collect an ever larger amount of milk from individual medium- and large-scale farms and to decrease their reliance on collection centres (evidence is given by the continuous closure of collection centres around the country). The efforts of the dairy processing sector to stimulate investments and expansion at the individual farm level are a crucial part of this evolution.

According to representatives of the sector, more of an effort should be made to include medium-size farms (20 cows and more) as beneficiaries of EU (rural) funds. There is a general feeling that most attention is devoted to the largest farms in the sector, while a lot of future development should be driven by the medium-size farms. Hence, their investment possibilities should be stimulated rather than constrained.

With respect to the 1-2 cow farms that remain omnipresent in the rural areas, the situation is different. Most of these units are either subsistence or semi-subsistence farms and are as such not bound by the strict EU rules on food quality and hygiene. This means that these farm households will continue to use their milk production to complement their food basket, and, in cases where farms are able to sell a small share of their production directly to the market\(^7\), to complement their often low pension endowments. This situation is likely to persist at least until the next generation.

Up to this moment, milk quality testing is performed exclusively by government laboratories. It seems that the government owned testing facilities have insufficient capacity to perform all quality tests within a reasonable timeframe, and at the lowest possible cost. The privatisation of milk quality control should be debated. (ANARZ)

\(^7\) In order to sell milk on the market, farms need to have quota – the share of 1-2 cow farms that registered and requested milk quota however is relatively low.
Other issues that were mentioned during the interviews were the following: Especially around Bucharest, real estate development is increasing so rapidly that agricultural activity is squeezed out. Farms are incapable of complying with environmental standards and are forced to close down their businesses. In other cases, farms are losing their farmland as leasing terms are ended and plots are reallocated to residence builders.

A specific problem arises from the high incidence of theft. Especially larger farms have to utilise a significant share of their resources to employ guards to protect the property, not only for example to prevent the theft of animal feed, but even to keep thieves from stealing the cows.

Farmers’ associations are not successful. It is difficult at any stage to find a common goal and even when associations are being formed, “Everyone just wants to have an important position”, says one of the interviewees. According to the USDA, farmers’ associations in the dairy sector are much less developed than for example in the hog or poultry sector. A possible reason for this is that only a few large farms exist in the dairy sector and that the sector as a whole is too fragmented to stimulate the development of producer groups.

3. Dairy Processing

3.1. Structure and extent of markets

The milk processing sector has undergone important changes in recent years. The number of dairy companies decreased from 831 in 2000 to 361 in June 2006. This decrease in the number of dairies was mainly the result of a decline in the number of the smallest processing units. Of the remaining 361 companies, 117 have a high processing capacity (> 2000 tons of milk per year), 165 have medium capacity (500-2000 tons of milk per year) and 79 are small processing units (< 500 tons of milk per year). (CEEC AGRI POLICY FP6 project report) The main companies in the market are: Friesland Romania; Danone; LaDorna; Hochland; Albalact; Covalact. (Retail Magazin 2006) Friesland Romania processes 170 million litres of milk annually. (Friesland website)

Although there are a number of strong players in the dairy market, one of the interviewed retailers pointed out that in each of the cities in which the chain is present – with the exception of Bucharest – dairy product sales are dominated by a local supplier. Possible explanations for this observation are the perceived freshness of the product and brand familiarity among the local population.

Furthermore, it seems that competition between the main players in the dairy market is limited. One of the explanations for this observation may be the geographical separation of the milk sourcing areas of the dominant dairy companies. For example, Danone is situated in the south east of the country and collects milk mainly from this area, while Friesland Romania is active in the north west of Romania. On the other hand, good payment policies and assistance towards supplying farms on the part of the dairy companies (see section 3.3 for more details) can be understood as a strategy to secure high quality milk supplies by discouraging suppliers from switching to other dairies.
Fresh milk and fresh dairy products (yoghurt, cream, fresh cheese) are the most commonly consumed items. This is mainly due to the high level of self-consumption of milk on farms and the importance of direct sales to consumers. At the same time, about 90% of the production of dairy companies also consists of this range of fresh products. In volume terms, the domestic market of fresh dairy products is structured as follows: 37% yoghurts; 22% soft cheese and spreads; 16% milk; 14% sour cream; 7% kefir and other sour products; 3% cream cheese; 1% cottage cheese. The yoghurt market in Romania is intensely competitive, with five important players: Danone, Friesland, Hochland, Campina and Prodlacta. These companies together hold 80% of the sales in volume and 87-90% of value sales.

Regarding external trade, Romania is a net importer of milk and dairy products, with the exception of cheese. (CEEC AGRI POLICY FP6 project report) The total value of dairy product imports in 2005 was 37,775 thousand USD, which makes it the fifth largest import category in Romania after pork meat (388,103 thousand USD), poultry meat (131,432 thousand USD), frozen fish and seafood (64,576 thousand USD) and beef (53,042 thousand USD). The main suppliers for imported dairy products in 2005 were Germany (35%), France (16%) and Poland (11%). (USDA, 2006a)

In 2006, Romania continues to import small quantities of raw milk for processing from neighbouring countries, but the country also imports processed, packed milk. Hungary is by far the largest supplier, followed by Germany, the Czech Republic, Slovakia and France. (USDA, 2006b)

The interviews show that dairy product imports have increased even further after accession. The main reason for this development are the high production costs to dairy processors in Romania. Furthermore, the quality, range and presentation of imported dairy products is perceived to be better than that of locally produced products. Border administration has also decreased significantly since January 2007.

3.2. Market institutions and policies

Regulations (EC) No 852/2004 and 853/2004 lay down hygiene rules for dairy processing companies. As mentioned in section 2.2, Regulation 852/2004 states that food businesses should operate food safety programmes and procedures based on HACCP principles. All food businesses should produce documents and keep records that prove the establishment of and compliance with the HACCP system and provide the competent authority with evidence of this compliance. Hygiene requirements also include provisions concerning buildings, equipment and personnel.

Regulation 853/2004 includes several provisions that concern dairy products. First, there are specific temperature requirements. Dairy processors must ensure that, upon acceptance at the processing facility, milk is cooled quickly to no more than 6°C and kept at this temperature until processing. Furthermore, the Regulation specifies requirements for the heat treatment of milk, i.e. pasteurisation treatment and Ultra High Temperature treatment. There are also specific criteria for raw cows’ milk that is used for processing: immediately before processing, raw cows’ milk used to prepare dairy products has a plate count of less than 300,000 germs per ml and processed cows’ milk used to prepare dairy products has a plate...

---

8 Other important import categories are: pet food (72,267 tsd USD) and distilled spirits (43,706 tsd USD)
9 The HACCP system was introduced in dairy companies on October 1st 2006. (USDA, 2006b)
count of less than 100,000 germs per ml. Finally, there are also provisions about the packaging and labelling of dairy products.

Of the 361 dairy companies that were operating in the Romanian market by mid-2006, 49 were compliant with EU standards, 217 were expected to comply by the date of accession, 75 were listed for the transition period up to 2009, and 20 would have to be closed down at the time of accession. (CEEC AGRI POLICY FP6 project report) By October 2006, only 329 establishments remained. Of these units, 59 were approved to export to the EU (“A” category), 188 were expected to be compliant by the time of accession (“B” category), 74 dairies were allowed a grace period (“C” category) and 8 operations would be shut down by the 1st of January 2007. (USDA, 2006b)

Dairy products from establishments that benefit from the grace period will be expected to carry a label identifying them as unsuitable for export. (Agra Europe Weekly, 101106) The label identifying products suitable for trade within the EU is referred to as the “oval mark”, whereas products that are allowed to be traded on the domestic market only receive the “round mark”.

3.3. Business conduct and skills

There are 3,233 milk collection centres recognised by the National Sanitary-Veterinary and Animal Health Agency. Most collection centres are owned by processing companies that have invested in them, equipped them and paid for their registration. This situation makes the producers dependent upon processors, it puts them in a weak negotiating position. For this reason, private collection centres, owned by producer groups, have begun to be established in recent years. However, there are still very few of those producer owned collection centres. In the second quarter of 2006, processors have started to close those small collection centres that would not be equipped to comply with EU standards for milk quality testing while remaining economically profitable. (CEEC AGRI POLICY FP6 project report) One of the interviewed dairy companies has seen a gradual decrease in the share of milk collected from collection centres and has plans to stop buying milk from collection centres altogether by June 2008.

Investment levels have been high at the processing level in recent years. Own resources from within the industry account for the largest part of these investments (70%). (CEEC AGRI POLICY FP6 project report)

Dairy companies have been actively involved in upgrading the level and quality of milk production in Romania. For example, Friesland Romania has created its ‘The first drop of care’ programme to complement the 2005/6 government programme that issued grants to farmers worth 60% of investment costs when buying milking and cooling equipment. Friesland Romania has offered the balance of 40% of the costs to 2090 farmers spread over 370 villages that were buying equipment. In exchange, these farmers will deliver milk to the company to reimburse the amount. La Dorna offers financial support to farmers who want to establish cow and buffalo farms (20 head) that comply with EU standards. The company covers 50% of investment costs and buys milk produced on these farms. (CEEC AGRI POLICY FP6 project report)

Danone Romania has several programs to assist their farms. There is an annual training programme for farms; feeding balance software is provided to larger farms; the company
manages an internal market (a kind of small-scale e-bay) in which farmers that wish to buy or sell equipment find each other; Danone has negotiated prices with important input providers and farmers can access these inputs while paying back the cost through milk deliveries. Furthermore, farmers can get one year advance payments (without it affecting the milk price). A special advance payment scheme is established for small farmers willing to expand their dairy operation and invest to become compliant with EU regulations.

An important factor in stimulating milk quality upgrading has been the milk price incentive schemes developed by private dairy companies. Annex II gives an example of a milk price calculation by Danone Romania.

There is evidence of vertical integration between dairy processing companies and dairy farms – where the farm is supplying at least part of the milk being processed in the dairy. However, it is not clear whether stricter quality and hygiene rules or other recent developments are stimulating this process.

3.4. Remaining transition challenges

The main challenges at the processing level are: the low share of total milk production that is being processed; high collection and transport costs; and the low quality of raw milk. As a result, processing costs have been generally higher than in the rest of the EU. Related to this is the challenge of increased possibilities for dairy product imports from other EU member states since 2007.

High costs of transport is one of the main challenges at the collection stage. High transport costs are due to the large number of small producers and hence the large number of collection centres collecting small quantities of milk, significant distances between the main production regions and the location of the main processing companies, and the poor condition of the roads in rural areas.

The interviews pointed out that transparency at the government level could be improved. The situation has actually deteriorated since the time of accession. Before, dairy companies and their associations were part of the negotiation structure at the Ministry of Agriculture through the Milk Council. However, since accession, new structures have been established and interest groups are no longer consulted in the decision making process, with changes in legislation only being communicated after their finalisation.

4. Retail of milk and dairy products

4.1. Structure and extent of markets

In 2006, 33% of retail belonged to the large-scale retail sector compared to 23% in 2004 (see Table 5). Although this increase is significant, the share of the large-scale retail sector is still low compared to other EU countries. For example, if we look at the number of hypermarkets per million inhabitants, Romania would only score 0.4, while this indicator will be 4.5 and 7.5 respectively in Poland and Hungary. Nevertheless, given the infancy of the retail market, analysts forecast a higher rate of development for Romania than for the region and other EU countries. As a result, the large-scale retail sector is expected to gain 50% of total retail sales.
by 2010. Figures 2-4 present a more detailed picture of expected developments in the retail sector in the following years. As can be expected, in the capital, the share of the large-scale retail sector in total retail sales is higher than the country average: 55%, of which 27% in hypermarkets, 23% in supermarkets, and the remaining 7% in Cash and Carry and Discount stores. (USDA, 2006a)

Table 5. Retail market structure in Romania – share in retail sales, 2004-2006.

<table>
<thead>
<tr>
<th>Retail format</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Large-scale formats:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Supermarkets</td>
<td>13 %</td>
<td>16 %</td>
<td>17 %</td>
</tr>
<tr>
<td>Cash &amp; Carry</td>
<td>7 %</td>
<td>7 %</td>
<td>6 %</td>
</tr>
<tr>
<td>Hypermarkets</td>
<td>2 %</td>
<td>4 %</td>
<td>6 %</td>
</tr>
<tr>
<td>Hard Discounts</td>
<td>1 %</td>
<td>2 %</td>
<td>4 %</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>23 %</td>
<td>29 %</td>
<td>33 %</td>
</tr>
<tr>
<td><strong>Small-scale formats:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Boutiques</td>
<td>43 %</td>
<td>43 %</td>
<td>42 %</td>
</tr>
<tr>
<td>Kiosks</td>
<td>2 %</td>
<td>2 %</td>
<td>1 %</td>
</tr>
<tr>
<td>Street Vendors</td>
<td>6 %</td>
<td>5 %</td>
<td>4 %</td>
</tr>
<tr>
<td>General Stores</td>
<td>6 %</td>
<td>5 %</td>
<td>4 %</td>
</tr>
<tr>
<td>Other formats</td>
<td>20 %</td>
<td>16 %</td>
<td>16 %</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>77 %</td>
<td>71 %</td>
<td>67 %</td>
</tr>
</tbody>
</table>

Source: USDA (2006a)

Figure 2. Number of outlets and sales* in hypermarkets, 2004-2011

* RBS = Retail Banner Sales
Figure 3. Number of outlets and sales* in supermarkets, 2002-2011

* RBS = Retail Banner Sales
Source: Planet Retail (2007)

Figure 4. Expected evolution in retail structures, 2002-2011

Source: Planet Retail (2007)

Table 6 shows the main players in the Romanian retail market. In line with observations from other CEE countries we notice the dominant position of foreign-owned retail chains.
However, concentration is still low in the retail sector. The combined share of the 12 companies in Table 6 (excluding Plus Discount for which sales data were missing) in total retail sales (17.5 billion USD in 2004) is only 20%. The top five retailers account for 18% of the retail market. In terms of share in the large-scale retail sector alone, the top-5 retail chains cover over 50% of the market. Figure 5 compares concentration in the Romanian retail market in 2005 to retail concentration in other EU member states in 2003. We notice that concentration levels in Romania are similar to those in Poland two years earlier, but well behind concentration in the retail sector in other markets, both in Central and Western Europe. It is expected that retail concentration will continue in Romania in the following years.

Table 6. Company profiles of the main retail chains in the large-scale retail sector in Romania, 2006.

<table>
<thead>
<tr>
<th>Retailer</th>
<th>Outlet types</th>
<th>Ownership</th>
<th>Sales 2005 (mio USD)</th>
<th>Outlets (number)</th>
<th>Location</th>
</tr>
</thead>
<tbody>
<tr>
<td>Metro</td>
<td>Cash&amp;Carry</td>
<td>German</td>
<td>1,560</td>
<td>23</td>
<td>Bucharest (4) and 16 other big cities</td>
</tr>
<tr>
<td>Selgros</td>
<td>Cash&amp;Carry</td>
<td>German</td>
<td>570</td>
<td>13</td>
<td>Bucharest (3) and 10 other big cities</td>
</tr>
<tr>
<td>Carrefour</td>
<td>Hypermarket</td>
<td>French</td>
<td>545</td>
<td>6</td>
<td>Bucharest (4), and 2 other big cities</td>
</tr>
<tr>
<td>Billa</td>
<td>Supermarket</td>
<td>German</td>
<td>312</td>
<td>19</td>
<td>Bucharest and main cities</td>
</tr>
<tr>
<td>Cora</td>
<td>Hypermarket</td>
<td>Belgian</td>
<td>221</td>
<td>2</td>
<td>Bucharest</td>
</tr>
<tr>
<td>Artima</td>
<td>Supermarket</td>
<td>Romanian</td>
<td>80</td>
<td>15</td>
<td>Medium-size cities in West Romania</td>
</tr>
<tr>
<td>Mega Image</td>
<td>Supermarket</td>
<td>Belgian</td>
<td>67</td>
<td>17</td>
<td>Bucharest (15) and 2 other big cities</td>
</tr>
<tr>
<td>Profi</td>
<td>Discount</td>
<td>Belgian</td>
<td>55</td>
<td>21</td>
<td>Center, South and West Romania</td>
</tr>
<tr>
<td>G’market</td>
<td>Supermarket</td>
<td>Turkish</td>
<td>50</td>
<td>4</td>
<td>Bucharest and one other big city</td>
</tr>
<tr>
<td>XXL Mega Discount</td>
<td>Discount</td>
<td>German</td>
<td>49</td>
<td>5</td>
<td>Bucharest and 4 other big cities</td>
</tr>
<tr>
<td>Univer’all and Uni’all</td>
<td>Supermarket</td>
<td>Romanian</td>
<td>44</td>
<td>11</td>
<td>Bucharest and 5 other big cities</td>
</tr>
<tr>
<td>Kaufland</td>
<td>Hypermarket</td>
<td>German</td>
<td>20</td>
<td>11</td>
<td>Bucharest (1) and other big cities</td>
</tr>
<tr>
<td>Plus</td>
<td>Discount</td>
<td>German</td>
<td>N/A</td>
<td>22</td>
<td>Bucharest and medium-size cities</td>
</tr>
</tbody>
</table>

Source: USDA (2006a)

By 2007 the top five of retailers on the Romanian market included the following companies: (1) Metro Group (38 outlets, 7% market share; (2) Rewe/Billa, XXL Mega Discount, Penny Market (86 outlets, 6.5% market share); (3) Carrefour (10 outlets, 3%market share); (4) CBA (490 outlets, 2.2% market share; (5) Schwarz Group/Kaufland (30 outlets, 2.1% market share). In total, the top five retail chains hold a 20.8% market share in Romania. At first
glance the situation looks little different compared to other CEE markets with only foreign companies playing in the top field. However, the situation in Romania is fundamentally different because none of the retail chains have yet reached a double-digit market share and we don’t yet see the hard and aggressive competition that exists between Western retailers in for example Hungary and the Czech Republic. Metro Group, the largest player, is mainly living from small independent retailers. (Planet Retail, 2007)

Figure 5. Consolidation in the retail sector*

* Data are for 2003 in the case of the United Kingdom, Hungary, the Czech Republic, Slovakia and Poland; and for 2005 in the case of Romania.
Source: IGD (2005) and USDA (2006a)

Interest in the Romanian retail sector is growing rapidly, with new stores being opened both by chains already present on the market and by new market players. For example, Real – the hypermarket division of Metro – opened its first hypermarket in Romania in 2006 and had five more store openings by the end of that year. Also, the Dutch retailer SPAR opened its first retail outlets in Romania in 2006 and intends to increase its network to 26 outlets by the end of 2007. Furthermore, French retailer Auchan has entered the market in the fall of 2006 and plans to open at least two hypermarkets annually. In the Hard Discount sector, Minimax discount is opening 30 outlets in Romania in 2006. (USDA, 2006a) Existing players on the Romanian market are also planning to increase their network. Carrefour has 40 hypermarkets in the planning stage in cities with more than 150,000 inhabitants, Kaufland will launch up to 50 hypermarkets around the country by 2010, and Cora has plans to open 14-15 hypermarkets by the end of 2010.

The catering sector (for restaurants and hotels) is a rapidly growing sector in Romania. As a result, wholesalers are increasingly focusing on this market segment and food services are developing fast.
4.2. Market institutions and policies

Foreign investment in Romania is easily possible in theory, although in practice, retailers need to take quite a number of bureaucratic hurdles. A foreign company is currently allowed to own a building in Romania, but not the land on which it is built. Obtaining building permission is not always easy. According to Tengelmann’s discount subsidiary Plus, the chain initially delayed its market entry by a year because it did not want to hand out bribes to obtain the necessary authorisation, adding: ”There are over 30 institutions to go to for all sorts of authorisations and they all expect something”. (Planet retail, 2007) According to one of the interviewees, it takes more than six months to establish a business in Romania.

It is illegal for retail companies in Romania to return products to their suppliers (except of course in cases of poor quality or non-compliance with requirements for example on temperature). However, several interviewees noted that this policy is not always followed.

In other main cities, building plots are more easily available than in Bucharest, but most retailers still focus on the Bucharest market for their expansion because of the larger purchasing power in the capital. (Planet Retail – Daily News, 110707)

4.3. Business conduct and skills

Competition between the traditional (small-scale) and large-scale retail sectors remains very strong, especially for food products. About 25% of shoppers frequently go to traditional/open-air markets, especially for fresh fruits and vegetables. Even in cities, about 50% of shoppers buy fresh fruits and vegetables as well as dairy products from traditional markets, while only 20% prefer to purchase these products in large-scale retail outlets. In rural areas, the traditional retail channels are even more important as there is limited access to large-scale retail. (USDA, 2006a)

A peculiarity of the Romanian market is the preference for non-branded products, sold in bulk at peasant markets, including homemade cheese, especially cottage cheese. In contrast to other dairy products, cottage cheese and pressed cheese consumption is not particularly influenced by price or advertising. (USDA, 2006b)

Private labels have been developed for the main food and beverage categories. The main retail chains that are selling products under private label are: Carrefour (Marca 1), METRO (Aro and METRO Quality), BILLA (CLEVER), Cora (Winny), Mega Image (365), KAUFLAND (K-Classic), PROFI and PLUS. (USDA, 2006a)

The interviewed retailers confirm that imports of dairy products have increased significantly since Romania’s accession to the EU. Especially private label dairy products seem to be increasingly sourced from abroad – where retailers with a presence in several EU countries often use the same dairy company to supply a certain private label dairy product to outlets in different countries.

There are very high entry costs to supermarkets for new product lines, as well as additional marketing costs (advertising, discounts). (USDA, 2006a)
Small stores purchase food products mostly from wholesalers or Cash & Carry outlets. (USDA, 2006a)

Given the expansion of modern retail, some supermarkets and hypermarkets started to develop their own logistical centres. For example, Tengelmann-owned discount banner Plus has launched a project to expand the storage capacity of its logistics centre in southern Romania by 50%. (Planet Retail – Daily News, 110707) Minimax discount has an operational distribution centre just outside Bucharest, which includes facilities for chilled and frozen products. This development has limited the role of wholesalers, although they keep on playing an important role for outlets in the small-scale retail market. In the medium to long run, market concentration is expected among wholesalers, as some companies may not have sufficient resources to fulfil the increasing needs of retailers. (USDA, 2006a)

One of the interviewed supermarket chains points out that they have centralised procurement for dairy products but do not (yet) have a central warehouse for fresh products. The reason for this is the limited shelf life of the majority of dairy products in their assortment. The delivery process cannot yet be optimised in order to make a chilled distribution centre worthwhile.

A relatively recent trend is the preference for yoghurts with longer shelf life, a tendency that developed with the hypermarket, supermarket and cash & carry networks. (USDA, 2006b)

The interviewed retail companies showed a mix of policies with respect to the quality of dairy products. Most retailers have both oval stamp and round stamp (see section 3.2 on dairy product quality policy) dairy products on their shelves. However, at least some high-end supermarkets exclusively offer dairy products from companies that fully comply with EU standards. Sales opportunities for local dairies that are currently benefiting from the grace period are therefore already limited to retail channels with less stringent quality policies.

4.4. Remaining transition challenges

For consumers, when deciding which products to buy, price is still the most important factor because of the low incomes of the majority of the population. (CEEC AGRI POLICY FP6 project report) Low average per capita income results in a high share of food in household expenditures (47% in 2005). Due to the relatively low purchasing power of consumers there is only a very small segment of the population that is buying novelty or high quality products. (USDA, 2006a)

In recent years, many retailers had to re-think their expansion strategy, especially in Bucharest and other big cities, since securing sites for construction became more difficult. Due to both land availability for large plots and land price, some retail chains oriented their expansion strategy towards smaller cities throughout the country. (USDA, 2006a)

According to the interviews, the distribution of chilled products is an underdeveloped sector in Romania. In essence, there is only one major wholesaler, Whiteland, which has a significant network of warehouses with chilled storage facilities.

One of the main issues raised in the interviews was the transport problem in Bucharest, with its huge traffic jams, lack of parking spaces and generally bad city policy. This is a problem for all deliveries, but especially so for chilled or frozen product deliveries (energy costs).
situation is exacerbated by the fact that retailers do not prioritise unloading of chilled products, so it can easily happen that dairy trucks are standing in line for several hours before being able to deliver their products to the shop. Furthermore, the fact that retailers are only now starting to invest in distribution centres for chilled/frozen products means that the products are still being delivered to each individual outlet separately.

5. Recommendations

The analysis of the Romanian dairy value chain has revealed a number of transition challenges. Below, recommendations are made as to how a variety of policy, capacity building, public and private investment measures may serve to overcome them.

5.1. Primary production

At the primary production level, the EU milk quota system impedes the rapid restructuring of the sector – the freeing up of quota through the decline of small farms is too slow to sustain growth in the medium- to large-scale dairy farm sector. In order to improve this situation, there should be a review of the milk quota system at EU policy level with a view to abolishing the regional system with its transfer restrictions and replacing it with a national system that does justice to the fact that not all regions of Romania are equally well suited for dairy farming. Also, quota trading should be made costless in order to stimulate the transfer of quota from low- to high-productivity farms, and the rapid conversion of direct sales quota to deliveries quota should be stimulated in order to prevent market distortions from manifesting themselves.

On the farm level, low average cow milk yields and high seasonality are due to a poor genetic base and inadequate feeding practices. Capacity building measures are required to make producers aware of the influence that both the genetic base and feeding practices exert on animal performance. To this end, training of veterinary service providers and field extension officers may be advised.

A substantial share of Romania’s total raw milk supply is of low quality (often, this substandard milk originates on 1-3 cow farms with and old farm operator) and will by the end of 2009 become non-compliant with EU regulations for food quality and safety. In terms of suitable policy, requesting an extension of the grace period during which sub-standard milk can be used for consumption on the domestic market only is recommended. Such a course of action would require a credible system of controls to be in place to ensure the separation of products destined for the local market and for EU markets.

At the same time, options for the upgrading of milk quality at the farm level through public-private investments should be reviewed. The creation of milk parlours with professional staff and milk testing equipment would be an option. Emphasis should also be placed on capacity building among dairy producers, with special attention to the provision of information about the implications of stringent EU milk quality regulations and about the actions that can be taken at farm level in order to improve raw milk quality and to ensure its compliance with EU regulations.
By the end of 2009, many rural families who have so far relied on milk sales as a necessary complement to their income (e.g. from pensions) will be shut out of the market due to their inability to deliver EU-standard milk. In order to counteract the effects that the loss of milk sales as a main source of income is bound to have, adequate social policies need to be in place.

Finally, farmers’ access to investment finance needs to be improved. By means of suitable policies and public investment, it should be ensured that more attention is devoted to medium-scale farms (20 and more cows). Presently, upgrading efforts tend to concentrate on the large-scale farming sector, neglecting medium-scale farms.

5.2. Dairy processing

In the processing sector, limits on high quality milk supplies are a major threat to a large number of small- to medium-scale dairy processors. Since the source of this problem lies in the primary production sector, the same recommendations apply as above. Additionally, efforts at capacity building should be made, e.g. by increasing processors’ awareness of the potential for the production of traditional dairy products from alternative resources, such as sheep, goat or buffalo milk. Important lessons about typical or traditional product development can be learned in other EU countries.

Adding further to Romania’s raw milk quality issues are insufficient capacities at government laboratories for milk quality testing. This bottleneck could be removed from the value chain if, through a combination of adequate policy measures and public investment, milk quality control laboratories were to be privatised and certified.

There exists a clear divide between different types of processing companies that has to be recognised: Medium- to large-scale dairy companies with access to high-quality milk supplies stand vis-à-vis small to medium-scale processors who operate at the lower-quality end of the market. Policy pertaining to the dairy sector must take into account that in the coming years, challenges faced by the two groups of processors will be very different, and that, therefore, policy choices that benefit one type of operation may hamper the development of the other.

Increasing prices for dairy products will weaken the competitive position of the Romanian dairy processing sector. This development is largely inevitable, seeing as higher product prices result from increases in the price of raw milk which, in turn, are caused by increasing quality requirements and higher feed prices. Thus, dairy processors should focus their efforts on improving supply chain efficiency. A key element in achieving this goal will be an upgrade of the supply base, in other words, consolidation at the farm level. Consolidation can be achieved through growth on individual farms, facilitated for example by private investment in the number of animals kept, which may result in a significant lowering of collection and transport costs.

Finally, deteriorating levels of transparency at the government level should be countered by involving key stakeholders from the dairy sector in the development of legislation and policies concerning ‘their’ sector.
5.3. Retail of milk and dairy products

In the retail and distribution sector, high degrees of bureaucracy are currently impeding or at least slowing down the process of starting up a business, bribing practices have evolved. The situation could be improved if deregulation took place in order to simplify the procedures for business start-up and development.

Presently, the distribution of chilled products is underdeveloped in Romania – there is only one main wholesaler with chilled storage facilities. Increased private investments in the cold chain, also at the downstream end of the chain, are called for.

Ultimately, the efficient and timely distribution of dairy products is also often hampered by congestion problems in and around Bucharest. Public policy should thus pay more attention to developing sustainable city planning and devise solutions to existing major traffic bottlenecks.
References

CEECE AGRI POLICY FP6 project report – Agro economic policy analysis of the new member states, the candidate states and the countries of the western Balkans, Third 6-monthly report: “Structure and competitiveness of the milk and dairy supply chain in Romania”


USDA, 2006a, “Romania – Retail Food Sector Update 2006”

USDA, 2006b, “Romania Dairy and Products Annual 2006”

USDA, 2006c, “Bulgaria Dairy and Products Annual 2006”

USDA, 2007, “Romania Trade Policy Monitoring – EU Accession: Expected Short Term Impacts on Romania’s Agri-Food Sector 2007”
Annex I. Dairy support policies in Romania in 2006
(Source: USDA, 2006b)

Various support measures for dairy cattle farmers are provided to help the recovery of the dairy sector.

Dairy cows are subject to a payment per head of:
- 200 RON\(^{10}\) per head at birth, if a calf resulted from artificial insemination;
- 100 RON per head at birth, if the cow had been conventionally inseminated by a certified bull;
- 200 RON per head at the age of 6 months for a calf that resulted from artificial insemination;
- 100 RON per head at the age of 6 months for a calf that resulted from conventional insemination with a certified bull.

Supplementary payments are to be disbursed for dairy cows in the following situations:
- 300 RON per head for all cows which are registered with the Official Performance Control Office;
- 100 RON per head for cows registered with the genealogic register;
- 200 RON per head for cows ecologically certified.

Price support for milk is provided in 2006 in the form of procurement payments to farmers who deliver their production to processors. The unit subsidy for standard cow milk (3.5% fat), delivered to processors and compliant with EU quality standards on germ and somatic cell counts is 0.3 RON/litre.

The unit subsidy for standard cow milk (3.5% fat), delivered to processors and compliant with standards required by the National Program for Raw Milk Quality Improvement (maximum germ count of 1,000,000/ml and maximum somatic cell count of 600,000/ml) is 0.15 RON/litre.

\(^{10}\) Exchange rate: 1 RON = 0.30 Euro
Annex II. Milk price establishment at Danone Romania.

The base price is calculated based on a 3.2% protein level and 3.5% fat content. Base prices can differ for example depending on the distance of the farm to the processor. Therefore, the base price in the example below gives merely an indication.

**Base price:** 0.76 RON\(^{11}\) / litre

**Protein premium:**
For each 0.1% protein content above 3.2% a premium of 5% is added to the base price.

**Quality premium:**
- Premium class: +15% of base price/litre
- First class: +10% of base price/litre
- Second class: +5% of base price/litre
- Third class: no premium

Premium class: < 50,000 germs/ml; <400,000 somatic cells/ml
First class: < 100,000 germs/ml; <400,000 somatic cells/ml
Second class: < 500,000 germs/ml; <400,000 somatic cells/ml
Third class (national limits): < 1,000,000 germs/ml; <600,000 somatic cells/ml

**Final price:**
(Base price + premiums)*fat content as share of base fat content

**Example:**
Delivered: 500 litres of milk of First class quality, with a 3.3% protein content and a 4.2% fat content.

Base price = 0.76 RON/litre
Protein premium = 0.038 RON/litre
Quality premium = 0.076 RON/litre

Final price = (0.76+0.038+0.076)*4.2/3.5 = 1.05 RON/litre

---

\(^{11}\) Exchange rate: 1 RON = 0.30 Euro