



Sector: Food Products

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Abstract:

The Bulgarian food processing industry has every chance to continue its positive development in the future, using the domestic competitive advantages such as good access to raw materials and low labor costs. Moreover, the possibility for start-up cooperation and joint ventures with existing producers can make the penetration of the Bulgarian market easier.

Introduction

Food processing is one of the historically traditional sectors of the Bulgarian economy. The importance of this sector is determined by its share in the total industrial output, which in recent years amounted to over 20%.

Market overview

According to the National Statistical Institute's Household Survey data, Bulgarians spend around 35% of their income on food and soft drinks, and a further 4% on alcoholic drinks and tobacco. On average, Bulgarians consume more yogurt (as much as 20kg per year per head), confectionery (such as cakes) and fast foods than their Polish counterparts, for example. Pork is widely consumed especially in the winter months.

Bulgaria's food industry has benefited from a substantial amount of foreign investment in value-added food processors, particularly in the dairy, confectionery and bakery sectors. Most recently, some Romanian companies were reportedly mulling moving their production bases to Bulgaria, in order to take advantage of the more favourable tax and business climate there.

Nevertheless, the food industry remains fragmented, with concentration only evident in a few sectors of the industry. Although multinationals are among the largest food and drink companies in Bulgaria, the bulk of market share continues to be held by small- and medium-sized domestic operators, with their continuing popularity attributed to their price competitiveness. However, recessionary and competitive pressures, coupled with the requirement to comply with EU manufacturing guidelines, are driving further industry consolidation. Some of the smaller players have recently been forced to close their operations.

Domestic producers have been hit particularly hard by the financial crisis and subsequent global economic downturn. Many responded with a massive scaling back of production, with a number suffering from deterioration of their financial positions. This loss of productive capital will make it more difficult for Bulgarian firms to respond to the eventual improvement in domestic and external demand. The expansion of discount operators in the country and the still-high unemployment levels will, to a degree negate inflation-driven value increases. This view is supported by the faltering demographic outlook, especially as food and drinks companies face the situation of having fewer aspirational consumers, in light of emigration of younger workers.

In the structure of the processing industry in Bulgaria, the processing of food occupies 19.8%, of beverages- 5.3%, of tobacco- 5.8%. The food processing has increased by 4.3% in comparison to 2009. The tobacco processing has declined by 8.6% in comparison to 2009. The beverage sector has declined by 10.2%.

The number of companies in food processing is 5456, in 2010 employment declined by 0.8% in comparison to 2009. Companies, which produce beverages, are 1688, employment among them in 2010 rose by 1% in comparison to 2009.

The minimum salaries for obligatory social security in 2012 in the industry of processing food are:

Production of chicken- 400 BGN for qualified workers, 950 BGN for managers

Production of beer- 365 BGN for qualified workers, 850 BGN for managers

Production of bread- 440 BGN for qualified workers, 800 BGN for managers¹

¹ Source: Bulgarian News Paper, Dnevnik

SWOT analysis

<p>Strengths</p> <ul style="list-style-type: none"> -The food manufacturing sector in the past attracted significant foreign investment, with multinationals building strong, even dominant, market shares in several key sectors such as confectionery. -On average, Bulgarians spend some 40% of their income on food, beverages and tobacco, reflecting in part low incomes but also owing to the relatively low cost of many other necessities. -Bulgaria provides a cheap manufacturing base, which had attracted Western European companies that needed to reduce production costs and expand into new markets. 	<p>Opportunities</p> <ul style="list-style-type: none"> - The food and drinks market is unsaturated and fragmented, providing plentiful growth opportunities for key domestic and foreign players. -Rising demand for convenience, owing to changing and busier lifestyles, will provide growth opportunities for goods such as ready-made and chilled foods. -Rising demand for novel and ethnic food and drink across Western Europe and beyond will boost demand for traditional Bulgarian produce and beverages. -The development of the country's mass grocery retail sector will boost access and exposure to new food and drink products
<p>Weaknesses</p> <ul style="list-style-type: none"> - Local food and drink producers still require significant investment and modernisation in order to compete with foreign companies. -Bulgaria's agricultural sector remains inefficient and technically backward, placing limits on supply to processors and retailers and posing serious economic problems in an open market. -Dented consumer confidence as a result of global economic problems has negatively impacted sales of premium-priced and non-essential items 	<p>Threats</p> <ul style="list-style-type: none"> -Many small food-processing companies are unable to comply with EU regulations and are closing down, negatively impacting on sector growth. -Bulgaria has barriers to entry, such as perceived excessive political interference in the divestiture process and a relatively high level of entrenched corruption. -Bulgaria's economic fundamentals, including high external risk, continue to represent barriers to entry. -Further EU expansion is likely to divert some foreign investment away from Bulgaria. -Domestic consumption in general will continue to suffer owing to fallen consumer confidence and also due to negative demographic trends. -Growth of discount retail format and private label brands will negatively impact values, especially as some food and beverage prices have fallen to their 2006 levels, although food inflation has begun to rise recently.

Dairy Market Segment

All conditions for production of quality dairy production in Bulgaria are present. Strong traditions, excellent climate, availability of quality workforce and low operational costs make this sector extremely attractive to investors. Bulgaria boasts a relatively dynamic dairy industry, supported by high per capita consumption of dairy products. Compared to other major EU producing countries, the production costs are significantly reduced, and all it takes is good transportation to the EU open market, which Bulgaria is a part of.

Most Bulgarian milk producers should restructure their farms in order to comply with the EU requirements and be able to sell milk to the dairy farms. 814 farms having 13873 cows are in the middle of this process of restructuring. 2656 farms have already met the requirements.



The major problem for the milk processing companies is the low quality of the raw milk. Around 70,000 animal farms have to be categorised again. This must happen to the end of 2011 so that milk complies with the EU norms and the Bulgarian milk processing companies could use it.

In November 2011, Bulgarian dairy companies were granted a two-year extension by the European Commission, in relation to the requirement that all companies must meet the EU legislation for hygiene standards. The move will allow around half of the 80,000 dairy farms in the country to continue operating. The original deadline had been set at the end of 2011, with many farmers unable to provide the funding for the upgrade. Around 75% of the funds are expected to be sourced from the Measure 121 of the Rural Development operational programme.

At the moment a large part of the raw milk material which the dairy farms use comes from Hungary and other EU countries as there is a shortage in Bulgaria.

A positive tendency in the milk processing industry is the consolidation of the dairy farms. Only in 2010 the export of dairy products from Bulgaria increased almost twice- from 19,000 tons to over 36,000 tons.

Following the EU accession, a number of foreign companies acquired local players. For example, Spanish private equity firm GED purchased FAMA (Bulgaria's third-largest dairy producer at the time, claiming a 12% market share by volume), with Greek Vivartia taking over the country's leading milk processing company United Milk Company – which claims spot number two in the yogurt market – for EUR18.7mn. More recently, in late 2007, Italian Cola Dairy Products (CDP) purchased a 60% stake in My Day, which is famous for drinking yogurts.

Meat Processing

In 2010 545000 cattle, 9200 buffaloes, 664000 pigs, 1.37 million sheep and 357000 goats were bred in Bulgaria. There is an increase only in the number of bred cattle-0.9%. The number of pigs decreased by 9%, of sheep-by 2.3%, of goats- by 1.2%, of chickens- by 8.4%. The number of animal farms decreased as well.

The production of meat sausages grew by 1% in 2010 in comparison to 2009. The industrial production of pork and beef covers only the needs for direct consumption in the store chains while the meat processing companies should use imports. Most often the frozen pork and beef is imported from the EU because it is cheaper than that produced in the country. The import is necessary because of the decrease in the animals bred in Bulgaria. This tendency is typical for the EU as well. In 2010 the production of meat products was 106,053 tons while that of ready food and meat cans- 14 000 tons.



In August 2010, 9 new approved standards were introduced in Bulgaria. All products produced according to these standards will carry the label "Stara Planina". Producers of such products are prohibited from using soy, potato starch, fibres, mechanically boned meat as well as other things in the production process. Also, there will be some restrictions of the use of salt in production.

Bakery and confectionery

The average consumption of bread and bakery per capita in Bulgaria was 108 kg in 2010. Households increased their consumption of this group of products by 2.1 kg per person.

Leading companies in the confectionery sector include Kraft Foods, Nestlé Bulgaria, Cadbury Schweppes, Altria Group and Nilana, which is engaged in the manufacture of biscuits, bread and cakes, among other goods, with many other companies engaged in import and distribution.

Canned food

Canned foods are considered advantageous from the point of view of durability and competitive pricing, features that have been highlighted by the faltering economy. The marketplace for canned food will continue to be shaped by factors such as slowly recovering consumer purchasing power and the entry of more discount MGR (Mass Grocery Retail) operators into the market.

Canned foods are, however, facing increased competition from other convenience foods, as well as the fact that Bulgarian cuisine is traditionally based on fresh ingredients. Domestic companies are lagging behind foreign manufacturers in terms of marketing support for their products, although the rising importance of larger-scale shopping in supermarkets and hypermarkets has benefited canned food sales.

Adela, Deroni, Nash Dom, Varna Plod, Kjustendilski Plod and Elvira are some of the more prominent local producers of canned foods, with a number of firms – such as Sofia Nait – dealing with imports and exports. Canned soups, fruits and vegetables are among the most popular products types.



Beverages

Bottled water and carbonates dominate the soft drinks sector. Bulgaria places highly in the EU in terms of per capita consumption of soft drinks, indicating the strength of the market, although this is clearly dependent on the wider economic performance.

The consumption of non-alcoholic drinks in the first half of 2011 is 678 million litres which is around 34 million litres less in comparison with the same period in 2010.

Consumers buy beverages of the low price segment and bottles for domestic consumption. There is a decrease of the consumption of bottled water- 5% for natural mineral water, 8% for carbon water, 7% for

the gallons of 19.5l. 4% less carbon drinks were consumed during the first half of 2011 in comparison with the same period for 2010.

The biggest decrease is for the fresh fruit juices and nectars- 8% less consumption for the first half of 2011. The segment of ice tea marks an increase of 2%. The consumption of energy drinks has decreased by 2% in the same period.

Brewery Market Segment

Bulgaria is on 18th place in Europe regarding the consumption of beer per capita. Beer accounts for around 40% of total alcoholic drink value sales and around 80% of volume sales in Bulgaria. Prior to the economic downturn, beer sales had shown particularly good growth, owing to comparatively low prices and manufacturer marketing efforts.

Carlsberg and Heineken dominate the Bulgarian beer market, with the latter leading with a value market share of about 37%, according to AC Nielsen. Local breweries include Boliarka, Ledenika & MM (which holds under 10% of the local market), Bullbrew, Lomsko Pivo and Agrima. The Lomsko Brewery is owned by diversified conglomerate Enemona.

In 2010 the consumption of beer shrunk by 4.5%. The reason for that is the low consumption in the bars, hotels and restaurants (a decrease of 13.2%). There is an increase in the sales of plastic bottles (10%) at the expense of glass bottles (decrease of 14%).

26 imported brew brands are concentrated in 1.5 % of the total beer consumption in Bulgaria. The high rates of import duties, the low purchasing power and the stable local production are factors that make the imported brands less affordable. Adding transport expenditures, the imported brands become twice as expensive as the locally produced brands, and this places them aside from competing to Bulgarian brew brands.

The brew market in Bulgaria however is defined as investment perspective due to the common trend of giving up spirits consumption in brew's advantage as well as the expectations of increasing purchasing power. It is considered that imported brew brands would have promising future at the Bulgarian brew market.

Coffee and tea market



Coffee is hugely popular in Bulgaria and sales have steadily increased over recent years. Consumers are shifting from consumption of bulk coffee to pre-packaged branded coffees, while foreign companies involved in the coffee market benefitted from the early 2008 removal of excise duties on coffee. Consumers are increasingly demanding fresh and quality instant coffee varieties such as espresso and mocha blends, especially on-trade.

Tea is less popular in Bulgaria than coffee and speciality teas such as green tea varieties and fruit/herbal teas have not yet found success on the market.

Major players in the Bulgarian coffee and tea market are Kraft Foods and Nestlé, while American coffee shop chain Starbucks also entered the market in late 2008. Kraft Foods has a local coffee-processing

factory, which is engaged in the production of Jacobs coffee brands (Aroma, Espresso and Monarch, as well as Monarch Intense). Other coffee trademarks owned by the company include Nova Brasilia.

Spirits

Bulgarian consumers view strong alcoholic drinks as a luxury and are prepared to pay a premium for high-quality goods for special events and as an occasional treat. However, frequency of purchase is falling, with consumers now more likely to opt for cheaper, lower-alcohol drinks such as beer and wine.

Leading companies in the spirits segment include domestic alcohol producers also active in other sectors, namely Carlsberg Bulgaria, Zagorka (Heineken) and Kamenitza (CVC Capital Partners), as well as more spirits-focused producers SIS Industries and Vinprom Peshtera. Vinprom Targovishte is the leading wine producer and is also active in the spirits market, which ranks it within the top 10 players in the overall alcoholic drinks market. The traditional Bulgarian spirit is plum brandy (rakija), although this has been losing popularity among younger generations.

Wine production segment

Wine production in Bulgaria has seasonal character due to specific climate conditions.

Bulgaria exports about 80% of its wine, and imports of wine are limited, as consumers prefer domestic products owing to their lower price and perceived higher quality. The wine industry is currently shifting its export focus eastward. Exports to Western European markets have fallen as overall consumption has declined, but exports to Russia, Ukraine and Asian markets increased substantially. Russian bans on wine imports from Georgia and Moldova in 2006 have allowed Bulgarian producers to achieve substantial increases in market share in these countries.



Bulgarian exporters report a weak increase in the export of wine. 21 million litres of wine have been exported in the first half of 2011 which is an increase of 1.1% in comparison with the same period of 2010. In 2010 the total amount was 57 683 000 litres. The biggest importer of Bulgarian wine is Russia (49.2% of the total export). A growth could also be noticed in the export to Romania, the Czech Republic and Hungary. At the moment Bulgaria is on the 17th place in the world regarding the export of wine. The local brands find markets in over 20 countries. Some of the old players on the market are expanding their assortment. There is an increase in the export to Romania (223.4%), the Czech Republic (107.6%) and Mongolia (101.7%) while a decrease is reported in the export to Poland, Great Britain, Belgium, Germany, Latvia and Lithuania. The local market for the first half of 2011 has been 41 528 372 litres.

The mass consumer prefers drinking cheap wines which is a problem for the Bulgarian wine industry. In 2011 85% of the sales of wine are in the price segment up to 4 BGN per litre of wine.

Retailers

Independent mini-markets, grocery stores and convenience stores still account for over 50% of outlets and sales, particularly in rural areas, with convenience stores proving to be the most dynamic format in this subsector, particularly where gas-marts associated with petrol stations are concerned. Open-air markets account for around 2.5% of food sales and are especially popular for their fresh fruit and vegetables. Hypermarkets, despite remaining low in number compared with supermarkets, command a higher value share per outlet, owing to their sheer size and product range.

In an effort to increase market share, hypermarkets have rolled out a number of additional service offerings including debit-card payments, currency-exchange offices, video rentals and newspaper booths. Germany's Metro and domestic retailer Fantastico also offer cafés and children's entertainment areas. Food promotions, discounts and taster sessions are regular features in both supermarkets and hypermarkets in Bulgaria.

Market trends

Major factors that positively affect the whole food processing sector could be determined in the following groups:

- Ongoing process of the sector technological infrastructure restructuring– establishment of capacities for production of proteins, enzymes, vitamins and spices.
- Ongoing innovation processes targeting: production of new type of food products, introduction of new high-tech equipment, techniques and technologies, improvement of quality, introduction of the EU standards for quality of foods and drinks and their packaging and introduction of environmentally friendly production processes and packaging.
- Increase of investments in the food processing and related bottling and new-packages activities.
- Introduction of the EU requirements related to Hazard Analysis and Critical Control.

Currently the food processing industry is increasing the export volumes and the quality of its products. Earlier a large number of the Bulgarian companies in the food processing industry were not able to comply with EU standards concerning safety and hygiene, and were thereby not allowed to export to the EU market.

Furthermore, the efficiency of the food processing industry is improving despite the fact that a part of the production equipment is outdated. However, at the same time the structural problems in the farming sector still provide negative synergy effects to the food processing industry. Hence, in order to utilize the production capacity fully in the food processing industry the competitiveness in the farming sector should increase as well.

One of the possible ways to achieve that is promoting organic farming and specialization within organic farming. The demand for organic food has enlarged significantly in many western European countries but this market trend is also being followed, though in smaller proportions, by the Eastern European countries. Bulgarian companies, as well, are trying to take advantage of the different market segments such as organic food production, which intensifies competitiveness. In general, the market for organic products is seeing great potential.

90% of the bio food and raw materials produced in Bulgaria are exported. The biggest markets for the Bulgarian products are Europe, North America and Japan. Essential oils and honey are usually exported to Japan, while vegetables, small fruits and crops are exported to Europe. Other bio products such as bio wine, sheep and goat cheese, cans are also sectors which have great potential. 2010 marked a growth of over 15% in sales on the Bulgarian market. The assortment of the bio food offered in Bulgaria grew from 1400 to 2000 articles while the number of companies dealing with import and distribution of such food grew three times.

Following the latest developments the food processing sector may benefit from the increased inflow of domestic and foreign investments, and the EU structural funds support. Several multinational companies within the food processing industry like Carlsberg, Kraft Foods and Nestle made large investments in Bulgaria. The existence of multinational companies is also increasing competitiveness within the sector,

providing better and more advanced machinery, transfer of knowledge and know-how about production practices etc.

Good opportunities in the sector exist for the creation of total production chains through a combination of selected companies in clusters covering primary sector, processing, sales and distribution. An important advantage of the sector is the presence of well-established food research and development institutions.

Food sales account for approximately 85-90% of supermarket sales. Since most Bulgarians do not own a car – there are around only 2.2mn car-owners in the country out of a population of an estimated 7.5mn - supermarkets are more convenient than hypermarkets for the majority of consumers and remain a regular feature in the daily lives of the population. However, surveys conducted by the National Statistical Institute found that consumers are more likely to start purchasing cars in the near future, providing a boost to hypermarket sales.

Conclusions and recommendations

Bulgaria needs to recapture its competitive position on the export market and for this purpose investment will be necessary. Investing in both physical and human capital will strengthen production and the capacity for competitiveness. Renewed sources of capital and equipment are needed and Bulgaria must also comply with EU quality and hygiene standards. Enhancement of vocational training in the sector is essential to utilize the improvements fully.

The Bulgarian food processing industry has every chance to continue its positive development in the future, using the domestic competitive advantages such as good access to raw materials and low labor costs. Moreover, the possibility of starting up cooperation and joint ventures with existing producers can make the penetration of the Bulgarian market easier. Investing in existing food producers could open the possibility to enter and strengthen the Bulgarian market position in the EU.

Ministry of Foreign Affairs of Denmark

Embassy of Denmark
The Trade Council
Dondukov Blvd. 54
Sofia

Phone no: (+359) 2 917 01 00
Fax: (+359) 2 980 99 01
E-mail: sofamb@um.dk
www.bulgarien.um.dk

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