

## MEDIA BRIEFING DOCUMENT

### THE SOUTH AFRICAN BROILER INDUSTRY: COMPETITIVENESS, TRADE AND OPTIONS FOR GROWTH AND DEVELOPMENT

#### 1. BACKGROUND

In most years, the **broiler industry is the largest sub-sectoral contributor to the value of agricultural production in South Africa and chicken is by far the most widely consumed form of meat**, especially by low-income households. The industry has been the subject of heated debate and significant policy intervention over the last few years. On the one hand, local producers argue that unfair competition from imports is harming the industry and has led to substantial production and job losses. They have been successful in obtaining tariff duty protection. On the other hand, traders and retailers point to what they see as limited domestic supply capacity, inefficiency leading to lack of competitiveness and the poor quality of locally produced chicken. They argue that the main reason for the industry's requests for tariffs is to increase profits at the expense of low-income consumers.

The objectives of this study, commissioned for the "EU-SA Partners for Growth Project" funded by the EU, are:

- **To gather and assess evidence on the causes and impacts of the current 'crisis' in the industry**
- **To identify underlying constraints to the growth, competitiveness and transformation of the industry**
- **To evaluate options for public and/or private sector and/or EU intervention.**

#### 2. PRODUCTION, CONSUMPTION AND TRADE

As in most other major chicken producing countries, production in SA is dominated by a small group of large firms. This follows from the high degree of vertical integration and the high capital requirements needed to achieve sufficient economies of scale to compete. With international competition driving down producer prices and profit margins per bird, **scale is essential for survival.** The seven largest producers account for about 80% of output, medium-scale producers about 14% and small-scale producers about 7%. Market developments in recent years have seen the down-scaling of production by one of the two dominant firms, probably accompanied by an increase in the degree of industry concentration.

Two fundamental characteristics distinguish the market for chicken in SA from countries exporting to SA: **the predominant demand is for 'brown meat'** – whereas offshore it is for 'white meat' – and most **locally produced frozen chicken contains about 15% brine** – whereas, offshore, brining is not permitted. Relative to offshore markets, the local price of brown meat is higher, so other countries find it attractive to export brown meat to SA. The logical response for SA producers would be to

export as much white meat as possible to take advantage of the higher price that it fetches in offshore markets. This has not happened so far for a number of reasons, some related to brining. A further significant difference is that the **percentage of chicken to which value is added** by processing into pre-cooked or marinated products is still low in SA by comparison to offshore developed countries.

Since 2008, total production of chicken in South Africa has barely shown any growth, fluctuating narrowly in the 1.5 to 1.6 million tons per annum range. Consumption during the same period has expanded at an average of nearly 2% p.a. **The shortfall in domestic production has been taken up by a steady increase in imports.** These almost doubled between 2010 and 2015.

To help protect jobs in the industry, SA government has responded by imposing ‘most favoured nation’ (MFN) tariffs<sup>1</sup> or anti-dumping duties<sup>2</sup> or ‘safeguard’ measures<sup>3</sup> on many categories of imports. However, this has **increased the local price of chicken.** The most widespread impact has been on frozen bone-in chicken pieces, which make up about 60% of local sales. Between 2011 and 2016, most imports came from the EU.

**In 2016, South Africa was the EU’s largest export market. Since the temporary ban placed on imports from some EU countries in 2016 following a disease outbreak, Brazil has been the main source.**

*Among key questions arising are: Why has the growth of output in South Africa been so slow for nearly a decade? And what strategies could be adopted to increase the rate of growth?*

### **3. REASONS FOR THE SLOW GROWTH OF DOMESTIC OUTPUT AND EXPORTS AND THE INCREASE IN IMPORTS**

It was found that:

- There has been a rapid increase in demand for chicken products not produced in SA in recent years, chiefly mechanically deboned meat, used to make products such as polony.
- Brining may increase the profitability of local production through adding to the mass of frozen chicken without adding significantly to the cost. But, together with the industry’s inability to meet the sanitary and phytosanitary (SPS) requirements of most offshore markets, it has largely precluded the export of generic chicken products.
- There has been little investment in additional local production capacity in the industry as a whole, over the past decade. The industry ascribes this mainly to growing competition from imports which have depressed the return on investment, and to the rising trend of input costs, in particular from

---

<sup>1</sup> In terms of World Trade Organization principles, Most Favoured Nation duties are the maxima that member countries commit to impose on other members, unless the countries are part of a preferential trade agreement, such as the EU-SADC Economic Partnership Agreement, which eliminated import tariffs on a wide range of goods in both regions, including chicken, to help promote trade and development.

<sup>2</sup> Anti-dumping measures relate to ‘situation(s) where goods are sold in a foreign market at prices lower than in the country of origin’

<sup>3</sup> Safeguard measures, which are actions against trade that may be regarded as fair but that overwhelms domestic producers and are used against an unforeseen surge of imports that threatens and/or causes injury to domestic producers. Usually such actions take the form of import duties on the goods concerned.

feed, much the largest component. However, the returns achieved by some of the leading firms, including the largest, have generally been good.

Conversely, several factors that are often argued to play a role, do **NOT** seem to account significantly for the slow growth of output and exports and the increase in imports, notably:

- The industry does not generally seem to have been subject to unfair competition from offshore exporters and, to the extent that it has, it has usually been able to secure effective anti-dumping tariff defence. Rather, it has tended to benefit from increasing levels of Most Favoured Nation (MFN) duty protection and, more recently, safeguard duty protection, neither of which imply unfair competition from abroad.
- The industry is not inefficient relative to most of its offshore competitors. In terms of technical and economic efficiency, in most years South African producers can equal, or better, all of the countries from which SA usually imports, other than Brazil and the US.
- Disease outbreaks have played a role in constraining the growth and increasing the costs of broiler production in South Africa, but do not appear to have been a major factor in most years.

#### 4. IMPLICATIONS AND OPPORTUNITIES FOR GROWTH

A **range of possible strategies for growth**, not dependent on import tariff increases and higher prices for consumers, were examined and the following conclusions were reached:

- a. As long as the dominant business model in the industry – defined most specifically by brining – continues, new investment and growth of total output are likely to remain slow. **Offshore markets do pay a significant premium for white meat** and, in the EU, South African exports would not be subject to the import duties payable by some of its competitors. But they are intensely competitive and South Africa is in most instances at a distance disadvantage.

So offshore markets for white meat may not be attractive enough to South African broiler producers to make it worth their while to try to overcome the country's SPS constraints. If they are to do this, they will probably have to take the initiative to develop and drive a public-private partnership with the Department of Agriculture to address these deficiencies, much as the ostrich and pork industries have done, and be prepared to foot most of the bill for this. Technical assistance from abroad to help build the capacity of the Department to facilitate exports could play an accelerating role.

For this to happen, the participation of Astral – now much the largest producer of frozen chicken pieces – will probably be essential. But the company's present growth strategy makes this uncertain. This focuses more on setting up new highly vertically integrated chains in other African countries than on exports from its South African operations. The strategy has generated good returns on investment and is being emulated by some other leading firms.

- b. **Entering or expanding their presence in offshore markets for value added, precooked or otherwise processed chicken**, involves meeting less demanding SPS requirements. Product differentiation of this kind also creates scope for greater profit margins, even if it entails terminating the use of growth stimulants, splitting production lines into 'for export' and 'for local' markets, and forgoing the profit advantages of brining. Several of the 'big 7' are already taking advantage of this and are increasing the percentage of value-added lines in their product

mixes, both for export and for the local market. This is a promising growth strategy. To be able to take advantage of this, government has a key role to play in developing bilateral trade relationships in countries where these do not already exist.

- c. As a major category of chicken consumed in South Africa – second only to frozen cuts by weight – there appears, at first glance, to be **substantial scope for local firms to expand by entering the production of mechanically deboned chicken**. But without high levels of protection, this is unlikely to be profitable and it is not clear what net addition to employment there would be.
- d. Compared to large-scale producers, small-scale producers tend to have higher costs of production/kg, but also realize disproportionately higher prices/kg than large-scale producers. The **main challenge and limiting factor for most small producers comes with marketing**. The size of the market for live birds is limited, while slaughtered birds compete directly with the lower priced products of large producers, perhaps with some locational advantage. For small producers to be able to compete effectively with large firms on a cost basis, the level of investment and the technical and business skills that are required are generally prohibitive. This tightly constrains the scope for an organic growth strategy for most types of small producer.
- e. **Small and medium contract growers** constitute something of an exception. There is significant scope for advancing sustainable transformation through assisting the growth both of production per grower and of the number of contract growers, but the amounts of capital needed are substantial – of order of R15 million for a sustainable enterprise – because the profit margin per bird is so fine. Loans for infrastructure at a concessionary rate of interest could help advance inclusivity. The potential for establishing new entrants through this route is likely to be limited to perhaps 50 across the industry.
- f. There is scope for **increasing the economic efficiency of South African broiler production through continuing to increase domestic soya bean output** in years when the international market price is favourable. Soya is one of the two main inputs of feed, but much of the country's requirements still have to be imported at a high cost. There does not appear to be a need to add to crushing capacity.

## 5. SUMMING UP

South Africa's International Trade Administration Commission (ITAC) is presently considering an application for additional MFN tariff protection by the industry, as well as a dispute in respect of the safeguard duties that currently apply. In assessing the merits of such applications and disputes, beyond legal principles, ITAC is continually going to be faced by the choice between higher local retail prices and jobs and investment.

In a country where there are exceptionally high levels of unemployment and labour is strongly organized and is a key supporter of government – whereas far more numerous consumers are not – and where levels of food price inflation are moderate, **applications for tariff protection can generally be expected to be treated favourably**. Countries exporting to South Africa and importers will have to live with this, but **local firms will be making a serious mistake to take this as a cue to ignore the need to expand their presence in foreign markets. This is where the greatest opportunities for growth most certainly lie. Government needs to play its part to assist.**

ANNEXURE: SOUTH AFRICAN BROILER PRODUCTION AND IMPORTS, 2018

SOUTH AFRICAN TRADE IN BROILER PRODUCTS, 2018									SOUTH AFRICA PRODUCTION (TONS)	TOTAL SA PRODUCTION + IMPORTS	% IMPORTS
HS CODE	DESCRIPTION	TOTAL IMPORTS (TONS)	EU IMPORTS (TONS)	% IMPORTS FROM EU	NON-EU IMPORTS (TONS)	% TOTAL SA CHICKEN IMPORTS	MFN DUTY	EU DUTY			
<b>020712</b>	<b>NOT CUT frozen</b>										
02071210	<i>Mechanically deboned meat</i>	154 507	2 233	1.4%	152 274	28.7%	0%	0%	-	154 507	100.0%
02071220	<i>Carcasses</i>	13 009	650	5.0%	12 359	2.4%	31%	0%	116 521	129 530	10.0%
02071290	<i>Other (including whole chicken)</i>	10 252	4 851	47.3%	5 401	1.9%	82%	0%	42 391	52 643	19.5%
<b>02071100</b>	<b>NOT CUT fresh or chilled</b>										
02071100	<i>Whole fresh</i>	-	-	-	-	-	0%	0%	53 366	53 366	-
<b>020713</b>	<b>CUT fresh or chilled</b>										
02071300	<i>Fresh cuts</i>	-	-	-	-	-	0%	0%	117 701	117 701	-
-	<i>Fresh soup pack/sundry</i>	-	-	-	-	-	-	-	9 728	9 728	-
<b>02071400</b>	<b>CUTS frozen</b>										
02071411-15	<i>Boneless cuts</i>	24 025	25	0.1%	24 000	4.5%	12%	0%	55 605	79 630	30.2%
02071421-29	<i>Offal</i>	49 571	10 619	21.4%	38 952	9.2%	30%	0%	228 128	277 699	17.9%
02071490-95	<i>Frozen Bone-in pieces</i>	287 070	50 946	17.7%	236 124	53.3%	37%	13.9% -35.3% <sup>4</sup>	984 915	1 271 985	22.6%
160231-39	<b>Value added (fresh/frozen)</b>	-	-	-	-	-	-	-	71 799	71 799	-
<b>TOTAL</b>		<b>538 434</b>	<b>69 324</b>	<b>12.9%</b>	<b>469 110</b>	<b>100.0%</b>			<b>1 680 154</b>	<b>2 218 588</b>	<b>24.3%</b>

<sup>4</sup> 13.9% applied January-August and 35.3% from September 2018.