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**THE INDUSTRIAL RECONSTRUCTURING OF THE AGRO-  
FOOD SECTOR**

**Final Non Confidential Report of the Project**

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## 1. THE PROBLEM OF UPDATING INDUSTRY IN TUNISIA

It is important at the beginning of this report to summarise the essential elements which have given rise to the Tunisian government's decision to establish a plan for economic recovery, as well as the factors which form the basis of the strategy to update the industrial system.

### 1.1 Economic development during the 60's and 70's

The country's economic growth after its independence in 1956 and throughout the 60's and 70's was due to the adoption of a centralised and protected economic system.

The same choice was adopted by many other developing countries, and ensured a more rapid and balanced development - thanks to the effective distribution of resources among different economic sectors and the government's centralised management.

The firms which have developed in this environment can be characterised by the strong and planned support they receive from the State:

- Facilitations for the creation of industrial firms were drawn up according to centralised planning criteria which often eliminated local competition and resulted in protected loans,
- Credit was facilitated to the maximum: many entrepreneurs had the opportunity of limiting their capital to 5% of the assets invested,
- Custom restrictions on imports meant practically no foreign competition,
- Most prices were fixed by the State,

- The legislative system has made it almost impossible for firms to go bankrupt because of the need to safeguard employment. In practice, it is possible for a firm to continue business without having to pay back financial costs to Banks.

In spite of their rigidity, these measures contributed to a rapid economic development and remarkable growth in the real GDP throughout the 60's and 70's.

## 1.2 The consequences on the economic system

However, the above situation has had certain consequences which have become part of the structure of the Tunisian economic system and which are listed briefly below:

- high debts for the firms on one hand and heavy exposure for the banks on the other
- tendency to develop vertically integrated production structures, meaning the capacity of the production is structurally underexploited.
- limited recourse to sub-contracting or to alternative forms of production investment (for example, equipment leasing)
- tendency for relations between producers and consumers to become static, both at the level of raw materials and semi-finished products and at the level of final consumption. It is very uncommon for a firm to cause competition amongst suppliers. Usually it has its "own supplier" and suppliers have their "own clients". Products evolve much more slowly in the market than in Europe.
- tendency for firms to deal only with fixed segments or market niches and not to contribute to the overall development of the market.
- level of technology and the quality of the products in general is relatively backward. This is due both to the isolation of the production system with respect to international markets and to the limited dimensions of the internal market which do not allow continual technological evolution.
- structural underdevelopment of the sales forces: the entrepreneur's actions in his own market are sufficient, above all where small and medium-sized firms are concerned, - taking

into account that the market, at sector level, is controlled by a limited number of subjects (clients and competitors).

- very limited attitude concerning the adoption of marketing policies. Factors such as market analysis, demand structure and trend, evaluation of the firm's position in relation to the competition - are very rarely taken into consideration when developing products and formulating company policies. The use of publicity or other forms of promotion as a means of investment is not common. This is even more true for firms operating in the large consumption sectors, as is the case with the majority of food products.

In short, a very widespread deformation has been noted at the level of "*production-oriented*" entrepreneurs. The internal requirements of the production system and the features of production means appear to condition the choice of products and markets instead of the contrary.

### 1.3 The adopted recovery plan

Faced with this situation, and following the economic crisis in the second half of the 80's, the country found it necessary to adopt a change in policy in order to be able to overcome two economic and industrial problems which were limiting their development:

- the limited dimension of the internal market which hampers the modernisation of production means and the expansion of Tunisian firms;
- the difficulty of increasing the firm's competitiveness, of stimulating technological adjustment and of stimulating industrial activity within the framework of a protected system, where competition between operators plays a relatively limited role.

The choice was between:

- maintaining a degenerating situation with artificial and relative stability, progressively isolating Tunisia from the level of the industrialised countries.
- entering the free market with a completely restructured Tunisian economy, but inevitably accompanied by the rupture of certain established equilibriums.

For the government, the choice of entering the free market has been concretely linked to two objectives:

- Tunisia's entry into the Free Exchange Zone with the European Union;
- Tunisia joining the GATT agreement which regulates international trade relations.

The application of the reform will be progressive (notably regarding the reduction of custom duties) and differentiated according to the economic sectors. Agriculture will be less affected by the reform and production will remain protected.

It follows therefore, that the application of the reform in the agro-food sector will only affect its industrial component.

Likewise certain activities such as the milk production and processing will not be subject to the reform while others will, but in the longer term (see the 4 lists of the sectors with timing and modalities of cutting down the different customs barriers).

#### 1.4 The application of the reform

The application of the reform will entail a profound change in the mentality, attitude and management methods of the entrepreneurs. In fact the market will be open to foreign competition, and companies will have to face challenges which they have not been accustomed to. The authorities also hope that this reform and the support measures they will apply will create the impetus companies need to start competing in new foreign markets.

Therefore, it is necessary to bring companies up to date in order to introduce the required changes.

The Tunisian government has recently considered the positive results of a similar plan adopted by Portugal upon its entry into the European Community. At the end of the '70s, Portugal, which is comparable in size to Tunisia, had a GDP equal to that of Tunisia today.

In particular the Portuguese government had very clearly separated the companies into two categories:

- companies in need of modernisation

- companies in difficulty

The latter were not eligible to receive updating assistance but instead received a different kind of support aimed at employees rather than at the firms. The emphasis was essentially on maintaining full employment, hence assistance was geared towards the re-qualification of personnel.

There are also a number of firms in financial difficulty in Tunisia. As a result of the experience gained during the diagnostic, the following categories of firms can be roughly identified:

#### **1. companies in need of financial stabilisation**

This is the case with many firms who having accumulated heavy losses are now unable to repay their bank credit. It has led to a large accumulation of debt with respect to the worth of the net capital. These companies will not be eligible for the updating programmes.

#### **2. companies in financial difficulty**

Although these companies continue to repay their debts, their balance sheets still show problems. Their funds are often below the norms generally admitted in Europe, and therefore they will need appropriate re-capitalisation (net capital on invested assets of at least 30%). In many cases in the agro-food sector (where the value added to products is generally not very high) the financial costs are very heavy with respect to industrial costs, thus causing prices to be high and uncompetitive in relation to the quality offered.

Unless they receive consequent financial restructuring which integrates the consolidation of their own funds, this category of firms will also be excluded from the updating programme.

#### **3. companies which need assistance for updating**

The companies may need the following:

- technical adjustment due to the obsolescence of their production system
- introduction of an integral quality system in line with European standards; involving a different organisation of the company's activities.
- reformulation of company strategies which should be based on a *marketing oriented* approach, which would entail awakening entrepreneur's awareness and a definite change in attitude.



Investments required for updating can therefore be divided into two categories:

- **material investments** (modernisation of plants)
- **immaterial investments** (marketing know-how, advertising, adoption of a quality system, etc.)

This analysis is supported by indications informally acquired on the criteria that the Tunisian government aims to adopt for updating. The programme - encompassing all industrial firms in the private sector having strong growth potential - deals with a series of aspects (technology, organisation, financial stability, professional training, etc.) and will lead to:

- the acquisition of new technologies (including plant renovation) as well as the acquisition of new know-how; a programme for reinforcing, modernising and developing the base industrial infrastructure is explicitly envisaged;
- the improvement of competitiveness by mastering quality and upgrading personnel qualifications; a programme for technical assistance and promotion of quality is envisaged.

Tunisian authorities have therefore intensified the awareness of entrepreneurs in all sectors so they can immediately start the updating programme.

The key words are: quality - technology - marketing.

Besides training and support programmes which will be provided by technical centres and specialised consulting firms, the government will put a great deal of effort on establishing co-operation between the Tunisian entrepreneurs and their European counterparts, in order to develop and intensify partnership and sub-contracting projects. These methods could effectively help companies save time in learning about market economy and free competition.

## 2. SITUATION OF THE AGRO-FOOD SECTOR WITH REGARD TO THE UPDATING

### 2.1 The structure and the weaknesses of the sector

Agro-food is the first industrial sector in Tunisia. It absorbs 40% of agricultural production and represents 20% of Tunisian exports. The sector can be divided into 10 sub-sectors which are classified according to the nature of the raw material used, the product developed and the type of adopted technology (the nomenclature is taken from the new code of investments):

1. Milk industry (dairy produce, yoghurts, cheese, ice-cream, etc.)
2. Edible oil industry (oil mill, refinery, extraction of oil from oil cakes and seeds, packaging, etc.)
3. Cereal and derivatives industry (flour-milling, semolina manufacturing pasta, couscous, bakeries, biscuit factories, baby flour foods, etc.)
4. Food packaging and canning industry (fruit and vegetable preserves, fish and meat products, semi-preserves, etc.)
5. Drying, dehydration, lyophilization
6. Sugar and derivatives industry (sugar refineries, chocolate factories, confectionery, yeast industry, etc.)
7. Soft drink industry
8. Frozen-food industry
9. Manufacturing of compound foods for livestock
10. Other food industries

The number of agro-food firms in Tunisia has risen to about 6,000. Although it is possible to find relatively large firms (with hundreds of employees) the average size is usually a small firm operating on the local or sub-regional market.

In relation to other industrial sectors, agro-food firms are generally less technologically advanced and in a position of greater vulnerability.

The most important weak points are essentially linked to:

#### *Raw materials*

- dependence on the supply of raw materials (directly or indirectly) from agricultural production which is becoming increasingly irregular.

The consequences are:

- a relatively critical financial situation caused by negative management results linked to unfavourable supply conditions;
- difficulties in expanding production during favourable periods of the market or when a product is successful, due to the lack of raw materials.

The seriousness of the situation varies according to the sub-sector. In some cases this difficulty is mitigated given the possibility of importing raw material if its value is sufficiently high with respect to transportation costs (in the case of flour, for example). However, the dependence on foreign currency is evident.

#### *Quality*

As far as its entry into the free market is concerned, the Tunisian agro-food sector is faced with a particularly serious problem.

European competition has been evolving for several years and has started to concentrate and automate production, as well as rationalising distribution to reduce costs; the quality of the products is carefully maintained, and has been standardised according to norms which apply to the entire firm (ISO 9000).

This system is capable of providing consistently high quality products at very competitive prices.

In Tunisia, on the other hand, the system is divided into a myriad of small firms and products are still of an inferior quality.

#### *Prices*

In spite of the particularly low cost of manpower, a series of factors considerably limits the competitiveness of the Tunisian product.

In particular:

- the price of certain raw materials is extremely high (with respect to international prices);
- the level of production automation is low
- the different branches concerned (in each sub-sector's chain: agricultural production, transformation, industrial production, distribution and marketing) have little or no co-ordination or integration and are very weakly rationalised;

If customs duties were completely reduced, this situation could cause many problems; competition with European products would be very difficult.

## 2.2 The principle differences in comparison with European products

There are a certain number of important differences between European and Tunisian products which are independent of material quality or price. Primarily, the differences can be found in the hygiene and safety standards which the firm should adhere to up until the final consumption of the product.

Furthermore, the majority of European products have been studied and produced with great attention to market demand; target consumers are analysed beforehand, and segmented according to social category, age, habits, purchasing power, etc.

The products are conceived, produced, controlled, packaged, distributed, presented and advertised according to the needs of each identified segment.

In particular, the products "contain" information which helps the consumer identify and choose according to its needs and, at the same time, stimulates consumption.

In practical terms this information is conveyed by the packaging but can also be supplied in other ways, such as the product's "name". However, it is the use of publicity methods which introduce the product and promote it on the market (press, radio and television, street bill-boards, etc.).

European products also contain other types of information on the packaging: information on the quality of the product (ingredients and attributes, origin, preparation and expiry date, specific dietary information such as calories, packaging, etc.).

According to the results of specific studies carried out in France, the "immaterial content" of food products counted for at least 72% of the product's value. This percentage also includes the transportation and marketing costs which vary according to product type, but it is the information component which is directly or indirectly linked to the majority of the product's cost.

As far as Tunisian products are concerned and particularly in the cases which were studied, it was shown that instead of being the result of a specific marketing study, a product is usually conceived as a result of the entrepreneur's intuitions or as an attempt to imitate foreign products.

The publicity of large consumption products in Tunisia is still not sufficiently developed.

The problem, therefore, is to update or introduce Tunisian products onto the market and it must be resolved decisively since:

- entrance into the European market and local competition will entail adopting systems to conceive and promote products aimed at satisfying the local client.
  
- television advertisements on European products will reach Tunisian consumers. This is due not only to the possibility of receiving European programmes (broadcasted by satellite or directly from the Italian and French coasts) but also to foreign exporters being able to purchase local publicity space (on television and in the newspapers) - once the free exchange zone is established.

### 3. THE RESULTS OF THE ANALYSES (PHASE II)

#### 3.1 Generalities

In accordance with the UNIDO's Terms of Reference, 11 companies have been considered. In particular:

- 3 from the wine-producing industry (UCCV, Takelsa, Grombalia)
- 3 from the fruit juice industry (JET, Tunisie Fruits, SFCJF)
- 3 from the biscuit manufacturing industry (Sotubi, Chabane, Biscuits Fins)
- 1 from the confectionery industry (Le Moulin)
- 1 from the essential oils industry (Aromat)

Taking into consideration the classifications mentioned in Chapter 1, the analyses carried out have shown the following situation:

Firms in need of financial stabilisation	4
Firms with financial difficulties	1
Firms needing updating	6

On the other hand, an abstraction of the financial situation would lead to the following classifications:

Important technological adjustment (renovation of plants, upgrading know-how)	8
Introduction of a quality system at European level	11
Adoption of a <i>marketing oriented</i> approach	11

At this point it is necessary to underline that the 3 firms who are not in need of an important technological adjustment are not in an optimal situation and improvements should nevertheless be considered. However their capacity to master the renovation in terms of knowledge and financial resources has been evaluated favourably.

A similar situation may be observed in Europe. Not all firms are at the same level of advancement and operators are continually pursuing the technological "optimum". In this sense, it is relatively easy to find backward companies in Europe without the support of specific programmes.

**However, the most important aspect is the backwardness in terms of quality and of the formulation of company strategies, which are often strongly oriented towards production (*production oriented*) and influenced very little by *marketing* concepts.**

This being the case, two important conclusions were reached in the study of the 11 cases analysed.

**investments needed for updating are immaterial rather than being destined for renovating installations.**

Naturally, technical investments are necessary and in certain cases indispensable, but without modifying quality systems and marketing policies the food industry in Tunisia will not be able to sustain competition from its European competitors.

In relation to the need to adopt a quality system in line with European standards,

**the updating should involve the whole branch concerned.** In fact the imposition of a high level of quality at any point in the chain, starting with the agricultural product and ending with the finished product, entails the application of the same standards at all other points. Therefore, it is not possible for the biscuit producer to demand a certain composition of flour from his supplier (with strict specifications on ingredients) if he is not able to control the quality of his product and the wheat which was supplied to him, etc.

Detailed considerations for each of the five sub-sectors analysed have been presented in the form of confidential reports to the firms concerned. The most important aspects are as follows:

### 3.2 The viticulture



The production system is very out-dated in all areas (agriculture, production and marketing). Plantations and production technologies are essentially the same as those established by the colonists and much more appropriate for the production of blending wines.

One of the causes of the backwardness in the renovation of the vineyards and the installations is the application of the 1970 law which did not encourage investments in quality at any level. The establishment of fixed selling prices by the ONV (National Office of Vineyards) - which is almost independent from the quality of the product - is the strongest conditioning element in the sector.

Agricultural yield remains very low and well below that of competing countries.

A certain backwardness in marketing and product presentation can also be found (quality of packaging, labels, and everything concerning the product's "image").

This is partly due to an absence of competition on the local market and has certainly prejudiced the Tunisian product on the external market.

It has also been noted that, in spite of a certain autonomy where exportation is concerned (thanks to the conventions of the UCCV and the ONV), the sales of Tunisian products have been confined to agents who often represent the competitor's products simultaneously (for example Moroccan wine). The products are therefore marketed in bulk without any attention to the specific brand.

The private sector's intervention in the production, marketing and exportation of wine in Tunisia is marginal given that the UCCV and the OTD represent 90% of the wine-making and 60% of the packaging capacities. In our opinion, the co-operative system adopted by the UCCV is absolutely not in question. This system is very widespread in the wine-making industry even in the most liberal countries.

A series of updating measures have been suggested to the operators, in particular regarding:

- agricultural activities (establishing a viticultural cadastre, rejuvenating and renewing plantations, plantation and cultivation techniques, varieties, etc.);

- production activities (controlling raw material, renovating wine-making and bottling installations, etc.);
- developing by-products (production of must, distillation of ordinary wines, use of the by-products of vinified grapes, exploitation of the marc, etc.); improving quality (control system, packaging, etc.)
- introduction of an integral quality system in line with European standards (ISO 9000)
- introduction of a commercial policy which is aimed more towards marketing concepts.

All of these measures would notably improve the industry's situation in this sector, but they would be incomplete if a decision by the ONV is not taken.

Our suggestion is that, at the very least, the Tunisian Government ought to introduce a mixed system whereby, in parallel to the action of the above-mentioned public institute, operators could fix marketing conditions and thus develop high quality products.

We are aware that a project of this nature is already being studied. Its approval should be encouraged, but it is also necessary to recommend an evaluation of the transitory effects caused by the change in regime, whilst at the same time, foreseeing a certain progression in the application time of the liberalisation measures.

### 3.3 The fruit juice industry

Fruit juices production can be characterised by three principal activities:

- Production and marketing of natural fruit juices without any further processing
- Production of concentrated juices, essentially citrus fruits, crystallised fruits and essential oils.
- Production of fruit juices from local or imported concentrated juice and drinks based on fruit juices.

Citrus and orange fruit juices are the most frequently produced products (by the three companies included in this study, "JET", "Tunisie-Fruit" and "SFCJF"), with a total global transformation

capacity of 14,000 tons. This capacity is under-exploited and even during the most favourable years has not exceeded 45%.

The sector's main problem is the availability of good quality raw material in a quantity which would allow competitive prices.

Contrary to predictions the national citrus production has not increased during the last years, despite waters from the North arriving at Cap Bon. The average production is around 200,000 tons with the principal varieties being:

The principal reasons for the sector's stagnation are:

- irregularity of rain and agricultural production, the weak yield (20-30 t/ha) - which is attributable to lack of water and insufficient maintenance (fertilisation, cutting, treatments);
- age of the orchards, diseased plants;
- high and unstable prices throughout the campaign. This is partly due to the above-mentioned reasons, but also strongly depends on the market price for the consumption of fresh produce. This consumption is constantly growing because of the increase in population.

The prices of fruit juices are relatively high in relation to those of fizzy drinks (up to 5 times as much) and the sales of juices and drinks with juice bases on the local market remain irregular and limited.

The transformers have great difficulties with supplies and consequently are not able to work at full capacity.

Even though technical improvements are necessary (precise indications have been given to the operators), updating the firms is also dependent on the resolution of problems underlying and related to agricultural production.

Solutions can only be found at an inter-sectorial level and require the following actions:

- **"Agricultural and Industrial" Integration.**

The acquisition of plantations of 400 to 500 hectares for each transformer should provide the factory with more than 50% of its needs (5,000 to 6,000 T/year) for an agricultural production in the order of 15,000 to 25,000 T/year. Moreover the application of measures to improve cultivation conditions (rejuvenation and recovery of plants, irrigation and systematic cutting, etc.)

should noticeably increase the yield per hectare. A rationally maintained modern plantation should produce a yield of 50 T/ha. This kind of solution can only be achieved with long term agricultural credit aid.

- **Establishing a national policy for the development of citrus fruit cultivation**

It is necessary to co-ordinate the transformers and bring them closer together:

- Ministry of Agriculture (the availability of irrigable land in 50 year renewable concessions and support measures)
- GIAF (agronomical production and services)
- fruit exporters
- industrialists
- banks (establishing an efficient system for long term agricultural credit)

### 3.4 The biscuit manufacturing industry

There are 14 biscuit manufacturing units in Tunisia, spread throughout the territory - two of which have closed down due to financial difficulties. In 1994 production was estimated at 33,000 tons.

It is difficult to determine the national consumption of biscuits since the market is supplied by various sources including the units mentioned above, informal installations and controlled and non-controlled importation from bordering countries.

The typology of the firms is very different and includes units which are well equipped and well organised from an industrial point of view, as well as other firms of the cottage-industry type.

Excluding the technical improvements which are more or less necessary according to the different categories of firms, it seems that the whole industry is affected by the following problems:

- quality of critical raw materials, flour is often bought from abroad because of irregular availability and quality, above all, the problem lies in the lack of quality control at all levels.
- lack of a quality assurance system in line with European standards in supply, transformation and packaging of the products. All these operations must be carried out under specifically regulated conditions.

The price of raw materials is a decisive factor in market success. Tunisia is famous worldwide for its quality, but is too expensive in relation to products offered by other countries.

Only one firm was analysed. The problems and requirements for updating are very similar to those mentioned in the previous industries.

To compete with other lesser quality products, Tunisian producers ought to carry out an active information policy on quality and composition in order to give an appropriate value to its products.

It has been noted that in this field too little effort has been put into contacting potential clients and making them aware of the products. Competing countries have their own representatives in the countries to which they import.

To be able to compete on the market, Tunisian producers should make considerable investments in marketing and improving quality. In particular:

- products offered should be of a quality which is demanded by the market;
- prices of products should be adjusted to the level of the competition's prices;
- producers should develop marketing.

Tunisia has an enormous potential which could be developed in the fields of essential oils, fragrances and perfumes. Appreciation errors in the past have meant losing a large market, such as the Rosemary market which has become very lucrative and could be won back if an appropriate support policy was established in the sector by the Ministry of Agriculture. Tunisia could also develop other products such as date essence, thus conquering other markets where up to date there is not too much competition.

#### 4. CONCLUSIONS AND RECOMMENDATIONS

The most important results of the diagnostic phase can be summed up in the following points:

1. The problems of up-dating the considered firms mainly concern the introduction of firms into the market, given that a modification of quality systems and marketing policies is of absolute priority in relation to the need for the renovation of technical installations.

Technical updating is obviously necessary and in certain cases indispensable, but in our opinion, these kinds of problems can be resolved partly by ordinary means such as bank credit and partly by other numerous forms of credit support which are available for renovating installations in Tunisia.

The evaluation of possible investment plans in line with those of their European competitors (generally having more capital) should take into account the consequences on the firm's assets and financial structure. In particular, Tunisian firms must increase their risk capital so that for the same quality and industrial costs, the financial costs do not prevent competition with foreign competitors.

Without neglecting support specifically for the firm's technical rehabilitation, we think that immaterial investments which are aimed at introducing a system in line with the European quality standards (ISO 9000) and establishing marketing attitudes are essential.

For this reason, the training courses planned for the end of this project have been formulated concerning these two points.

2. Updating should involve all the branch concerned. In fact, the imposition of high quality at one point in the chain, leading from the agricultural product to the finished product, entails the application of the same standards at all other points.

The programme should be prepared in the interest of all the aspects involved. A transformer adopting the ISO 9000 integral quality standards should obtain the same standards from his suppliers, and therefore ensure a well organised and an all-round assistance.

3. The case of firms needing financial stabilisation or firms in financial difficulties seems to be very important. The analyses carried out have revealed the scale of the problem. In principle, the situation should not be a problem - in view of the entry in a free market system - since these firms could be taken into bankruptcy, or could undergo different treatment (firms in difficulty).

The problem arises when the above-mentioned firms occupy a key position in their industry. In the case of bankruptcy, the Tunisian market would be open to total unprotected competition. This is the case, for example, in the fruit juice industry where difficulties afflicting the Tunisian transformers have allowed large scale foreign competition.

One solution could be to set up an appropriate period of technical assistance ("tutoring") for the firm (provided by a high level consultant), as a guarantee for a recovery intervention which would be financed or co-financed by bilateral or multilateral co-operation bodies (the other party being the Tunisian government).

Financing would be granted following re-negotiation of the debt with the local Banks and after the preparation of a *Business Plan* which would demonstrate the capability of the new management to repay the debt. This would be possible within the framework of a sales expansion plan and modernisation of the management in the new free market.

This kind of intervention has recently been experimented in southern Italy with good results (Law 44 in favour of young entrepreneurs) and similar interventions are under discussion or experimentation in Eastern Europe.

Informal action has been carried out to verify the willingness of the Italian government and other international bodies to participate in setting up such interventions in Tunisia.

The problem was presented to a representative of the Italian government (Mr Cerulli) during April 1995 in Rome and the possibility of assistance from UNIDO was considered.

A meeting was held with a representative of the World Bank (Miss J. Press) on 24 and 25 May 1995 to present the proposition.

The response to these proposals will obviously be given after an official presentation by the Tunisian government since the contacts cited above were established in a completely informal manner.

Fidimi Consulting remains available for technical and organisational collaboration in setting up this solution.