

Introduction

The aim of this section is to illustrate which markets represent the greatest overall opportunity for South African floriculture products. Once the markets have been established, the specific products that represent the strongest opportunity in each market can be identified. Prior to this, we will first examine the overall opportunity, in terms of revenue and employment, for South African products to the world-wide market.

I. Assessment of overall opportunity

In 1998, the total imports (at exporter revenue value, not retail value) of floriculture products were US\$6.85bn. This was broken down as follows (in US\$000):

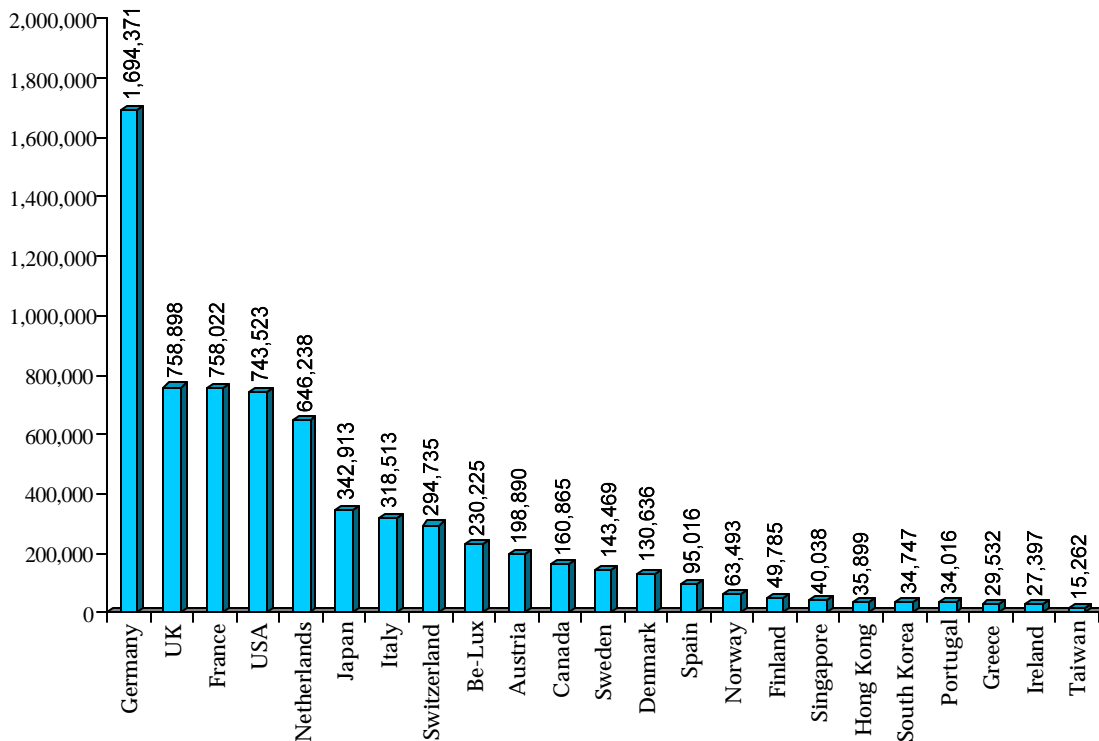


Figure 4: 1998 Total floricultural imports by country of import
Source: AIPH

South Africa has 0.44% market share of the world import market. Percentage market share, by country, for South African floriculture is as follows:

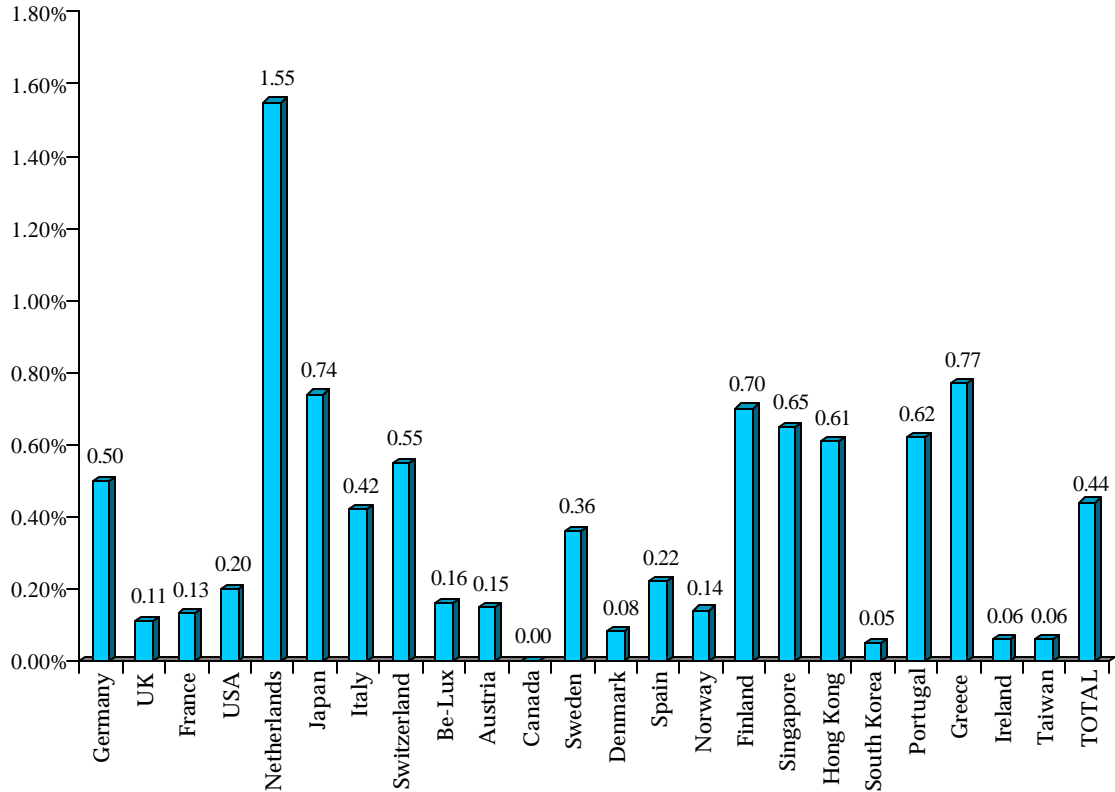


Figure 5: 1998 SA penetration of world imports
Source: AIPH

Given South Africa’s diversity of product range and strong infrastructure (relative, for example, to other SADC countries), **0.44% of the world market is a fraction of South Africa’s true potential.**

Take, for example, the export revenues of developing nations, most of whom have a one-product-one-market strategy:

Country	1998 Export revenues (USD)
Colombia	\$367m
Costa Rica	\$126m
Kenya	\$118m
Zimbabwe	\$53m
South Africa	\$30m

Figure 6: 1998 Total floricultural exports
Source: AIPH

By implementing the initiatives identified in this document, **South Africa can expect to achieve between a 2.5% and 3% market share of world floriculture imports over the next 10 years**. This, at current world growth rates represents **US\$260m of exports for South Africa at an average compound annual growth rate of only 24%**.

Building South Africa's competitive advantage

Background

South Africa has **an inherently strong competitive position** due to the following factors, which can all be classified as **'natural' advantages**:

1. The **demand for South African indigenous products is strong world-wide**, and particularly in the target markets identified (UK, Germany, Japan and Holland)
2. The **diversity of South Africa's product range will protect its growth** from sudden shifts in demand (geographical and product)
3. **South Africa's climate will guarantee it will always enjoy seasonal advantages** supplying to the Northern Hemisphere

Kaiser Associates discovered during the course of its research into the dynamics of the world floriculture market, that whilst **these natural advantages** may always bring South Africa a certain level of success, they **are not enough to make it a significant player in the world floricultural market for two main reasons**:

- 1) **South Africa's indigenous products are being copied and improved by its competitors** at an alarming rate due to the fact that there is currently **no protection strategy** in place.
- 2) The true basis for competition lies **not in direct production factors (cost, climate, etc)** but in **non-price factors** such as quality perception and delivery capability which rely on efficient supply chains and strong enabling environments.

Indigenous products in danger

South Africa's indigenous products, particularly proteaceae, are **rapidly "losing their indigenoussness"** as South Africa's competitors in Europe, the Middle East, the US and the Pacific Rim begin to **cultivate large quantities of these products**.

Not only does this mean that our indigenous product is being scattered across the globe, but so too are the researchers dedicated to these products. **Many South African experts are emigrating to better paid and better funded research projects for protea and fynbos in Europe and Australia**, whilst South Africa continues to block the entry of "foreign" scientists brought in to bolster resources here and to teach South Africans, for example, the latest post-harvest and flower farm management techniques.

The plant materials for these formerly unique indigenous products, now internationally grown, enter foreign territories in primarily legal ways. **South Africa’s indigenous research institutes (predominantly the ARC) have been forced to share South Africa’s natural products with other floriculture producing countries out of a desperate lack of resources dedicated to keeping them in South Africa. Specifically, the ARC has had to sell off cultivars from its commercial nursery in order to fund research**, as it has not been properly funded from within South Africa. Also, it has been forced to embark on joint ventures with competitors such as Hawaii in the US, in order to fund proper gene-bank research. If things continue as they are **it will not be long before protea (the national flower) suffers the same fate as freesia or gladioli**, which were also once indigenous South African products.

Basis for competition

Kaiser Associates conducted a detailed analysis of South Africa’s key competitors by product in each market to answer the questions:

- Who is South Africa directly competing with in its target markets of the UK, Germany, Netherlands and Japan?
- How is the competition beating South African products in these markets?

In looking at its direct competitors by product to UK, Germany, Netherlands and Japan, Kaiser Associates identified the following countries as being the greatest competitors:

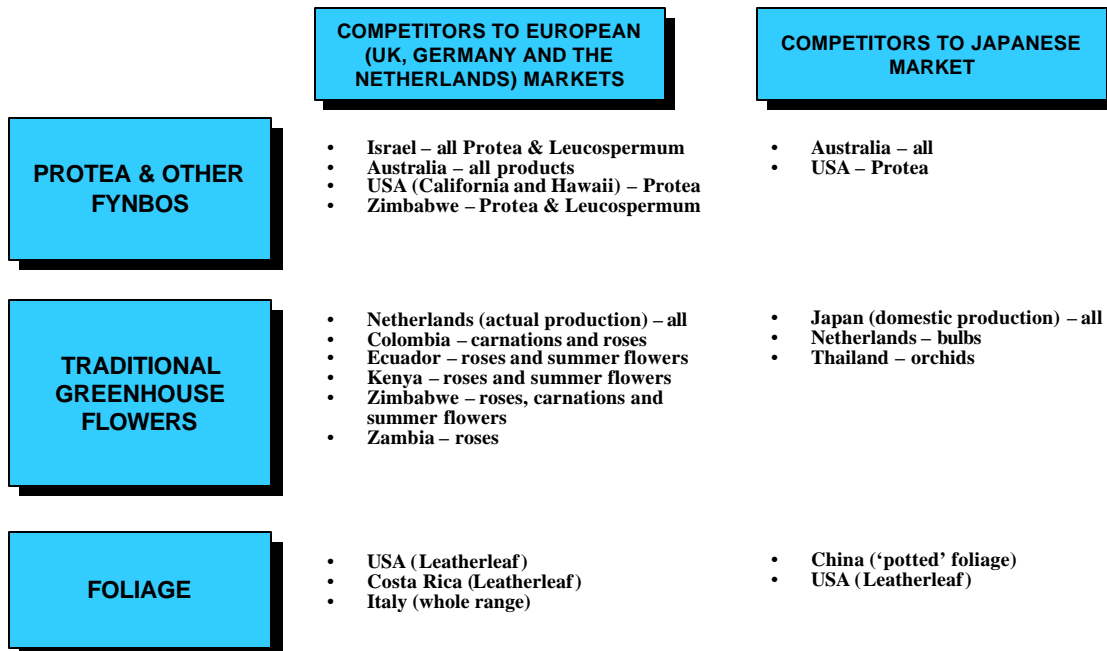


Figure 7: Competitors to South Africa in European and Japanese markets (by product)
 Source: Kaiser Associates

In order to determine the basis for each competitor's advantage, Kaiser Associates analysed each country's strengths and weaknesses. Once this analysis was completed, we were able to validate the idea that South Africa was not losing out on price factors to its competitors, but rather on **quality perception** and on **other non-price factors** such as its ability to deliver sufficient quantities of product on a consistent basis with guaranteed freight space.

The most illustrative examples of the fact that in order to maximise potential revenue growth a country must compete on a strong support system rather than just on its natural advantages are Australia and Israel. **Australia** has all the natural advantages (climate, etc) that South Africa has but **due to its lack of investment in its enabling environment and value chain, it has not been able to make a significant impact on the world's floricultural market, exporting a mere \$28 million annually.** **Israel**, on the other hand, has few "natural" advantages, but with significant investment into its enabling environment (particularly R&D and marketing), it **has managed to become a major player on the floricultural scene exporting \$185 million a year.**

The summary of the strengths and weaknesses of each competitor can be found in the DFD.

Therefore, the best way for South Africa to gain competitive advantage is by building a world-class export capability with an efficient supply chain and a fully developed enabling environment to support the export of high quality, innovative products to high opportunity markets.

Employment and capital investment

Floriculture, as a whole, has some of the most attractive employment ratios. A social accounting matrix study conducted by the Agricultural Research Council analysed the floriculture sector against 48 agricultural and manufacturing activities. Floriculture was ranked:

- Sixth in potential employment
- Sixth in potential value added per R1 million invested
- Fourth on Gini ranking (potential for improved wealth distribution)
- Third in terms of the overall multiplier effect

Within the floriculture sector, **employment in indigenous products is, on average, 4 times greater per rand of capital investment** than for intensive greenhouse products (roses, carnations etc.). On a per hectare basis, **greenhouse products employ over twice as many people than that of indigenous.**

Capital investment (including infrastructure) also varies greatly from product to product. In short, **capital investment for intensive greenhouse products is, on average, over 10 times greater than that of indigenous products per hectare.**

The specific numbers, for both employment and capital investment, are as follows:

Product	Capex/ha (including infrastructure) – R000	Employment/ha	Employment/R1m of capex
Traditional greenhouse products	1,800	20-25	13
Protea/fynbos (indigenous)	170	10	59
Foliage (indigenous)	220	10	45

Figure 8: Capital expenditure and employment creation
Source: Kaiser Associates/IDC

The average employment across the three groups (i.e if R1 million were invested in each) is **39 people per R1m of capital expenditure**.

The total floriculture industry currently employs approximately 17,500 people. Based on the above profile (and taking into account product mix and economies of scale), an increase in exports from \$30m to \$260m would **create further employment for over 80,000 people**.

II. Markets

Process for market prioritisation

Based on the analysis of the 15 countries below, Kaiser Associates classified the world's floriculture import markets into the following five categories:

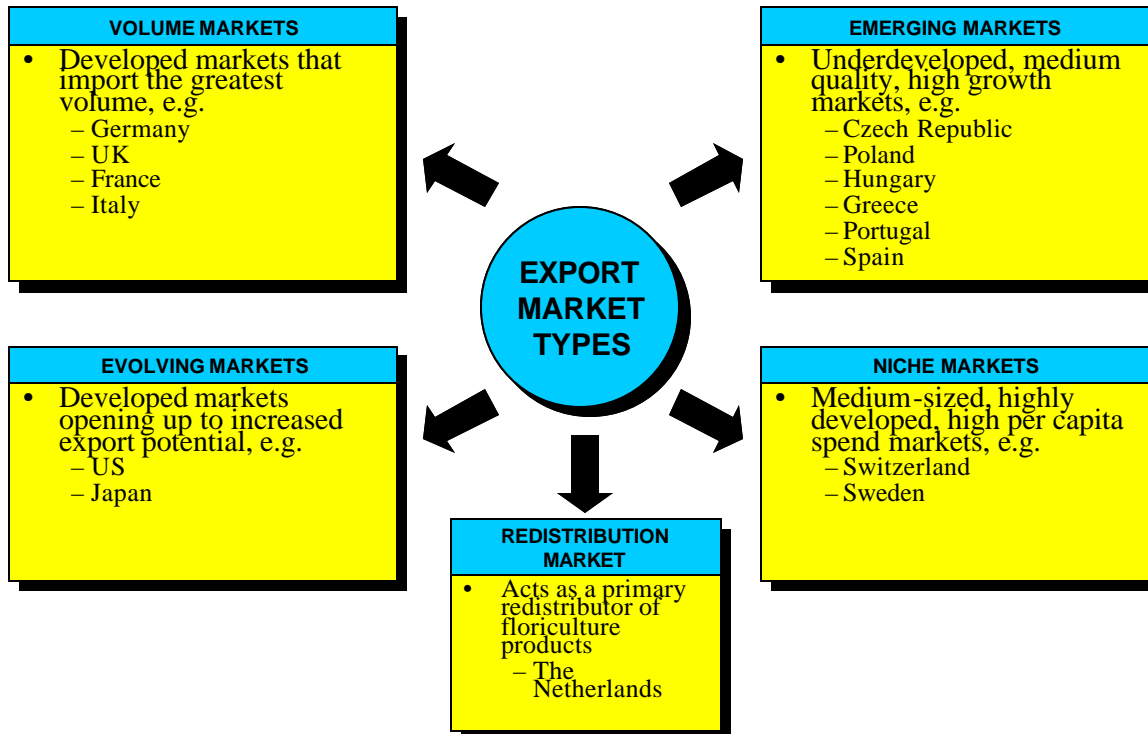


Figure 9: Market classification
Source: Kaiser Associates

Each of the countries in the above categories were screened using the following criteria:

1. Overall market size
2. Size of markets for imports
3. Fit with South African products
4. Market dynamics
 - a. Import tariffs
 - b. Phytosanitary requirements
 - c. Local distribution
 - d. Intensity of competition
5. Ease of logistics to market

Full details of the screening results for the 15 countries can be found in the DFD.

The summary of the strengths and weaknesses of each market category is as follows:

1. VOLUME MARKETS	
Pros	Cons
<ul style="list-style-type: none"> • Size (\$1bn-\$6bn per market) – account for 90% of EU imports • Subject to EU phytosanitary regulations – relatively relaxed • Relative proximity to South Africa • Well developed distribution infrastructure – except Italy • Receptive to ‘new’ exotic varieties – good ‘fit’ with SA indigenous varieties 	<ul style="list-style-type: none"> • Subject to EU import duties • Slow growth (<3%) – Except UK (>15%) • Very quality-sensitive • Strong competition, dominated by intra-EU trade (particularly the Netherlands) • Increasingly ‘mass market’ due to growth in supermarket channel – increasingly price sensitive • Significant pressure on airfreight
2. EVOLVING MARKETS	
Pros	Cons
<ul style="list-style-type: none"> • Huge retail markets (\$7bn - \$14bn) • Reasonable growth rates (5–10%), particularly in imports • Dominated by traditional varieties but significant recent demand for ‘new’ exotics • Well developed distribution infrastructure 	<ul style="list-style-type: none"> • Dominated by domestic/neighbouring suppliers • Strict phytosanitary requirements • Extremely quality sensitive • Distance from South Africa
3. EMERGING MARKETS	
Pros	Cons
<ul style="list-style-type: none"> • Forecast for strong growth (>20%) • Low sensitivity to product quality • Relatively low intensity of competition – non-core markets for Netherlands • Relative proximity to South Africa 	<ul style="list-style-type: none"> • Small markets (< \$500m each) – small populations • Low per capita spend • Under-developed distribution infrastructure • Low retailer concentration – limited scope for ‘direct sales’ • Immature markets with only minimal demand for ‘new exotics’
4. NICHE MARKETS	
Pros	Cons
<ul style="list-style-type: none"> • High per capita spend • Good fit with South African indigenous products • Relative proximity and average freight capacity • Good distribution infrastructure – scope for increasing direct sales to supermarkets • Relaxed phytosanitary requirements 	<ul style="list-style-type: none"> • Highly price sensitive • Low long-term growth • Highly quality sensitive
5. THE REDISTRIBUTION MARKET (NETHERLANDS)	
Pros	Cons
<ul style="list-style-type: none"> • Cost effective way of reaching low volume markets • Good fit with South African indigenous products • Relative proximity and some freight capacity 	<ul style="list-style-type: none"> • Highly competitive • Significant mark-ups • Highly quality sensitive

Figure 10: Pros and cons by market type
Source: Kaiser Associates

Conclusions on market prioritisation

After taking all the above factors into consideration, the overriding conclusion was that **the most significant short-term opportunity across all product types lies in shipping direct to volume markets**. Their size, their product preferences and the historical relationship with South Africa makes them the number one forex generator. **Evolving markets (the US and Japan) are markets that exhibit an increasing growth in imports, (markets are opening up more), an increasing fit with South African products and a well established distribution network**. For these reasons they represent the second highest opportunity category for South Africa. **Emerging markets, despite extremely attractive growth rates, are simply too small for significant forex, and consequent SMME employment growth. Niche markets (also considerably smaller) present significant quality and infrastructural challenges for South Africa in the short term.**

Therefore this exercise, and the resulting details below, focuses on specific countries within the **volume** and **evolving** markets.

Note: the primary purpose of this exercise was to generate as much foreign exchange and employment growth in the short to medium term. In fact, **by achieving significant growth in the short term, increased volumes will pave the way for the most effective penetration in the medium to long term**. Therefore the **focus on volume and evolving markets in the short term does not mean that specific opportunities do not exist in other markets**. For example, specific initiatives around **traditional greenhouse flowers to emerging markets** (particularly Eastern Europe) will yield healthy returns for individual farmers but should not be the focus of industry overall. Similarly, **the niche markets also represent specific opportunities for high value-added bouquets**.

Volume markets

Two volume markets in particular were selected for their overall opportunity across the floriculture range:

1. Germany
 - a. Highest per capita spend on floriculture of all volume markets (at US\$85 a year)
 - b. Largest floriculture importer in the world (US\$1.69bn at exporter revenue value) – 79% of total market represented by imports
 - c. Largest importer of South African indigenous products, particularly foliage
 - d. Second highest refrigerated air freight capacity from SA (after the UK)
 - e. Handling and reliability record of Lufthansa considered one of the best for perishable products
 - f. Strong growth in supermarket channel offering increasing direct selling opportunities
 - g. Well developed distribution infrastructure within Germany itself

2. The UK

- a. Significantly lower per capita spend than Germany (US\$34 a year) but growing at the fastest rate
- b. Strongest projected growth rates for imports (>15%) of all volume markets, particularly for unusual (indigenous) products
- c. Second largest floriculture importer in the world (US\$ 759m at exporter revenue value) – 70% of total market represented by imports
- d. Highest refrigerated air freight capacity from SA – served by three primary airlines (SAA, British Airways, Virgin)
- e. Extremely strong trade links between with South Africa
- f. Supermarket channel has very strong control of the market (43% of total) offering the greatest direct selling opportunities across all volume markets
- g. South Africa has significantly lower market share of the import market at 0.11% (compared to 0.44% overall, 1.55% Netherlands, 0.50% Germany) – ***This is the most significantly under-exploited market for South Africa***

A full analysis of the German and UK markets can be found in the DFD.

Evolving markets

With the US and Japan being clearly the main contenders within the evolving markets, Japan surfaced as providing the best opportunity:

3. Japan

- a. The largest floriculture consumer in the world (US\$6.9bn)
- b. Per capita spend (currently US\$55) is growing in line with economic recovery
- c. Although less than 10% of the market is accounted for by imports, the market is opening up to imports of all non-domestically grown varieties
- d. Japan is South Africa's third largest export market for floriculture products (after the Germany and Netherlands)
- e. Strong product fit with preference for indigenous and 'exotic' products (Protea, Fynbos, foliage, orchids, lilies and mixed bouquets)
- f. Relatively easy marketing access due to dominance of wholesale chains
- g. Strict phytosanitary requirements in the process of being relaxed

A full analysis of the Japanese market can also be found in the DFD, together with a more high level analysis of the US and the Netherlands.

The redistribution market

Although the emphasis of the South African floricultural strategy is on selling direct to volume and evolving markets for domestic consumption, it remains true that there is also opportunity across other market types. Until South Africa's floriculture industry is able to invest enough in marketing, sales and logistics resources in these other markets, the

South African floriculture industry should continue sending product to the main floriculture redistribution market, the Netherlands.

The Netherlands is the centre of the world floriculture market both in terms of production and trade. **Over 90% of its imports are re-exported giving it control of 54% of the world's total floricultural exports.** Its central distribution role makes it a “window on the world's” developments and product trends.

The Netherlands offers two unique ways of re-distributing South African product to the rest of the world: **through wholesalers and through the auction system.** Wholesalers represent the preferable channel for South Africa in the short, medium and long term if South Africa continues to focus on indigenous or other specialised products, as it will guarantee better prices than auction. **If South Africa focuses on commodity products it can successfully use either channel, as long as the quality matches international standards and the product types pushed through that channel remain in high demand.**

Although volume has increased through the Dutch auctions over the last few years, **Holland's overall share of the product flow is slowly decreasing at a rate of 1-2% per annum.**

A further description of the Dutch market can also be found in the DFD.

Other market opportunities

Although the UK, Germany, Netherlands and Japan offer the best short-term opportunities for South African products, there is also opportunity in markets such as the US and Eastern Europe, but these are better left for medium term focus markets. **These markets were dismissed for now due to difficulties with South Africa's support systems including logistics, and quality perception that currently impede its ability to compete properly in these markets.** Opportunities across all markets also exist within the supermarket channel, for example, but again South Africa must first invest in securing its reputation as a reliable supplier before it can realise this opportunity.

III. Products

Classification of product opportunities

'Floriculture' products, for the purposes of this exercise (and for the best way to categorise opportunity) has been divided into three main areas:

1. Indigenous products
 - a. Protea and other fynbos (Proteaceae)
 - b. Foliage (eg. Leatherleaf, Coral ferns etc.)
 - c. Indigenous bouquets (combining a. and b.)
2. Traditional greenhouse products
 - a. 'Classics' (Roses, Carnations, Chrysanthemums etc.)
 - b. 'Exotics' (Orchids, Lilies etc.)
 - c. Summer flowers (fillers, eg. Gypsophila, Monte Casino etc.)
 - d. Traditional bouquets
3. Mixed bouquets (combining 1. & 2.)

Process for product prioritisation

Using the above categories, Kaiser Associates conducted a screening analysis to identify the highest opportunity products in the short, medium and long term, using the following criteria:

1. Market demand/product preference
2. Current South African export volumes
3. Perception of South African products
4. Ease of increasing capacity

A summary of the findings against the above criteria can be found on the next page.

<p>Market demand/product preference</p> <ul style="list-style-type: none"> • Largest volume demand (world-wide): traditional greenhouse products (although highly competitive and commoditised) • Strongest growth in demand: novelty, variety, exotic (indigenous) 	<p>Current South African export volumes</p> <ul style="list-style-type: none"> • Top export products: Protea, other fynbos and indigenous foliage • Penetration across all products unnecessarily low (average 0.44%)
<p>Perception of South African products</p> <ul style="list-style-type: none"> • Indigenous products: generally good quality, good continuity of supply and (obviously) strong associations with South Africa • Traditional greenhouse: lower quality and non-cost competitive (both primarily perception-based) 	<p>Ease of increasing capacity</p> <ul style="list-style-type: none"> • Traditional greenhouse products most flexible in terms of capacity increase (less market reaction time) although more capital intensive • Indigenous products require limited capital investment although cycle time significantly greater for indigenous cut flower cultivars

Figure 11: Results of product screening analysis
Source: Kaiser Associates

Product prioritisation

Based on the interviews with the 15 top floriculture importing markets, and in particular the top target markets of Germany, UK, Japan (and Netherlands), Kaiser Associates arrived at a product prioritisation plan. The prioritisation criteria focuses on identifying the highest demand products in the short, medium and long term in order to determine the product areas for immediate production and export focus from a physical standpoint.

Although there will be an immediate ramp up of physical production in certain indigenous product types, there still needs to be concurrent enabling environment investment across all product types.

NB: This product prioritisation plan focuses on production and export volumes only. This does not dictate all investment levels, merely those relating to physical production.

The production prioritisation can be summarised as follows:

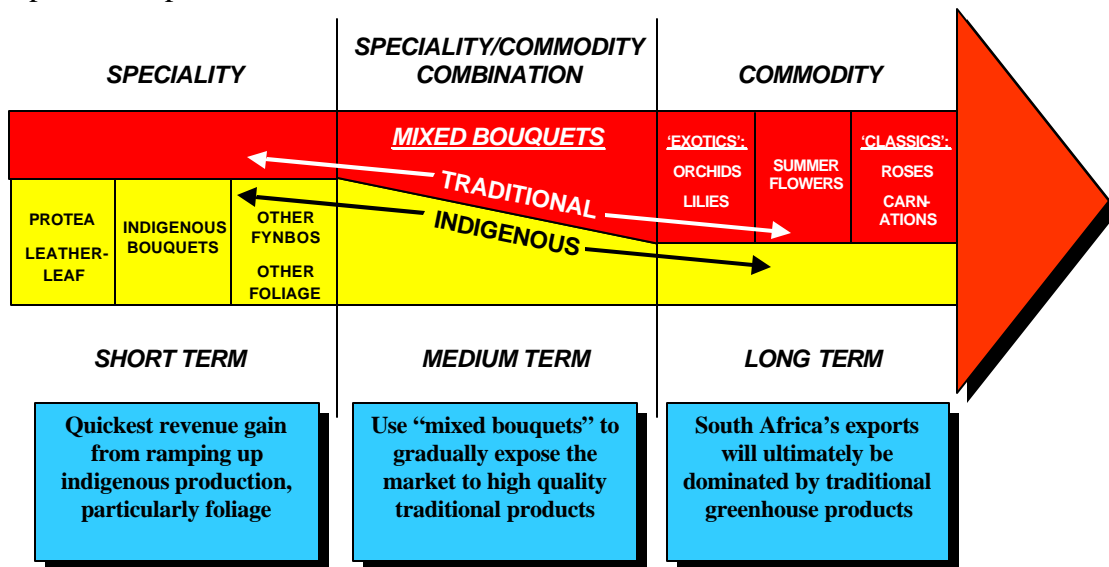


Figure 12: Product prioritisation model (based on production volume focus)
Source: Kaiser Associates

By concentrating first on increasing the scale of its indigenous product exports, South Africa will realise the quickest gain in revenue and employment due to the high value added labour intensive nature of the products. South Africa currently exports \$12m in foliage and \$9m of protea and other fynbos (together over 70% of SA's total exports) mainly to the European, US and Japanese markets, yet market demand for these products is significantly higher and inward buying trips from these markets indicate **a continual increase in consumer demand for these "novelty" products**. The only way for South Africa to ensure that it capitalises on the revenue gain and associated employment creation opportunities deriving from its "natural" competitive advantage in indigenous products is to increase production and export of these products (foliage, proteas and other fynbos) as quickly as possible.

Once the market demand for these products has been satisfactorily serviced and the South African floriculture industry is recognised as a high quality and consistent volume supplier, South Africa can start larger-scale production of a wider product range and export significantly increased volumes of traditional greenhouse products. Therefore, while initial production increase concentrates on indigenous products, **in the long run it will be critical to also ramp up production of traditional greenhouse products**.

The key to developing a robust industry based for the most part on traditional greenhouse products is **to prepare the markets for traditional greenhouse products through the use of mixed products over a transitional period of time**. Essentially this means that as soon as South Africa has gained a strong foothold in the target markets with its indigenous products, **it must begin sending mixed bouquets of indigenous and traditional greenhouse products in order to slowly expose the market to South Africa's traditional greenhouse products**. In order for this to succeed, the quality of the

traditional products must match if not surpass the quality of the indigenous products supplied in order to preserve South Africa’s established reputation as a quality supplier.

Whilst the focus on production will be on speciality products as a first priority, simultaneous investment in the enabling environment for all products will set the scene for diversification. In other words **while the indigenous growers are focused on producing volume, the rest of the industry will be investing in marketing, logistics and sales improvements to improve South Africa’s delivery capability for all products**. Marketing and sales initiatives in the main target markets will **focus on changing perceptions about South African products as being low quality or protea only**. Logistics initiatives will improve freight rates and freight space issues so that South African growers will never have to turn down orders due to unreliable transport. By the time the mixed bouquet strategy is in place, **the enabling environment will be in place to support a South African floriculture export industry based primarily on traditional greenhouse products**.

Bouquet assembly and improved distribution capability

As bouquets not only play an important role in the transition of South Africa from a predominantly indigenous product exporter to a predominantly traditional greenhouse product exporter, they are increasingly important **as the supermarket channel world-wide grows**. **South Africa should explore the possibility of assembling bouquets overseas for ease of distribution**. Kaiser Associates proposes that the South African floricultural industry considers investing in a **European depot for the assembly of bouquets** which would allow more efficient exports to smaller volume markets such as Eastern Europe and the niche markets of Switzerland and Scandinavia. For example:

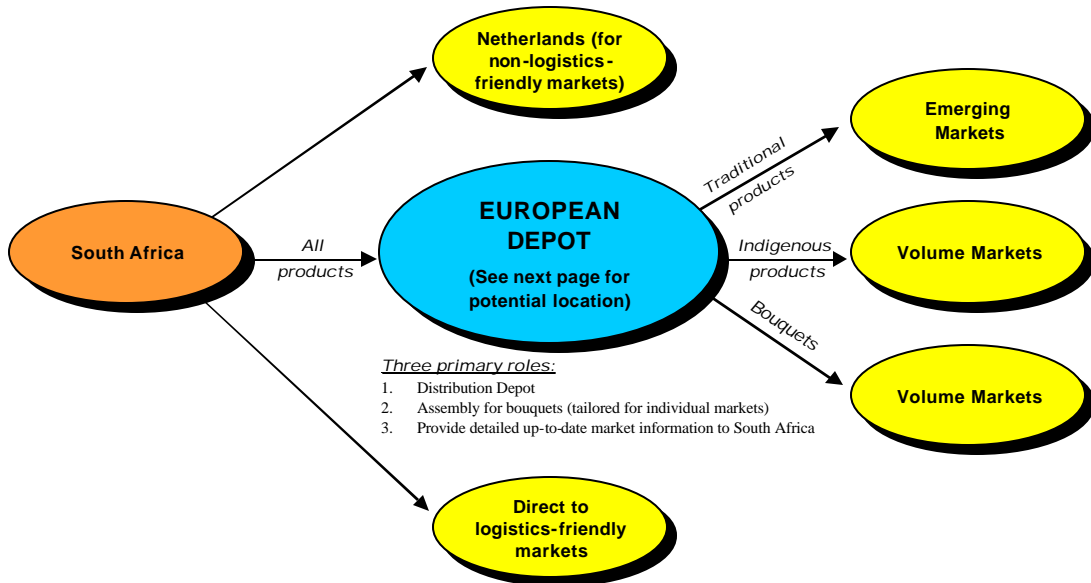


Figure 13: European depot scenario
Source: Kaiser Associates