

PANORAMA



France: will the organic agrofood sector be forced to abandon its principles?

The agrofood industry is facing a number of challenges in Europe¹, including the central issue of how to share created value. To meet these challenges and consider ways to guarantee a healthy, safe and sustainable food supply, the French government held a General Assembly on the topic of food from 20 July to 30 November 2017. Expanding the organic sector of agricultural production seems to be one of the best ways to achieve this, as this market is booming both in France and around the world. France is the third-largest market for organics in the world (Eur 5.9 billion in 2015, or 7% of the total market; Coface estimates that it is likely to reach Eur 8 billion in 2017), behind the United States (40 billion in 2015 or more than 40% of the total market) and Germany (11%), and just ahead of China, Canada and the other major European economies.

However supply in France seems to be struggling to keep up with this burgeoning demand, and 29% of these products are imported. This imbalance might lead one to think that few businesses in France have converted to organic. And yet, our study found that companies in the sectors that have embraced organics are more robust than the rest. According to our model, a 10% increase in the share of organics

in total production for a sector, is associated with an 11% decrease in insolvencies for companies in that sector.

In light of this, increasing yields, through innovation and/or expanding areas used for organic agriculture, is a key issue. Another important question relates to distribution through established specialised stores, which, in the face of increasing competition, may be forced to restructure. The market for organic products is a considerable source of growth, and mass retailers are going beyond launching their own brands of organic products and are now opening fully organic stores in response to the market share gains made by specialised distributors since the beginning of the decade. Also at issue is whether the market will finance the sector considering the changes to public subsidies maintenance for organic crops. Ultimately, the booming demand for organic products will inevitably result in changes to the sector, which may be interpreted either as an adaptation or as an abandonment of its principles.

^{1/} Each quarter, Coface publishes a country and sector risk Barometer, which evaluates risks for 160 countries and 13 economic sectors; our current assessment of the agrofood sector in France is "medium risk".

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COMPANIES ARE STRUGGLING TO KEEP PACE WITH CONSUMER DEMAND

7
THE FOUR KEY FACTORS FOR TRANSFORMING THE ORGANIC SEGMENT



**BRUNO DE MOURA
FERNANDES**
Economist



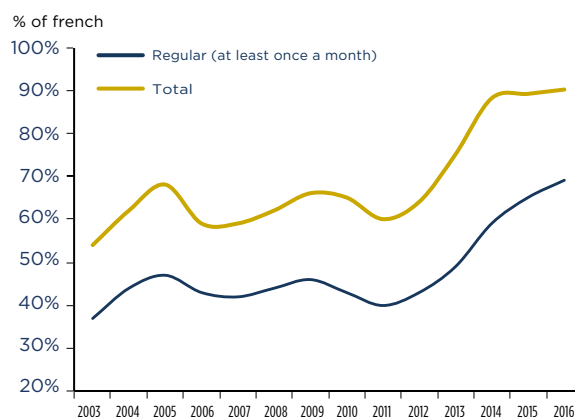
SARAH N'SONDE
Head of sector research

1 COMPANIES ARE STRUGGLING TO KEEP PACE WITH CONSUMER DEMAND

A booming market

Organic agricultural products have gradually become a fixture in household market baskets, with nine out of ten French people consuming them in 2016³, compared to a little over half in 2003⁴ (see *Chart 1*). And yet, growth has not been linear over the past ten years: the proportion of households that consumed organic products was comparable in 2004 and in 2012 (a little over 60%).

Chart 1:
Proportion of organic products consumers



Source: Agence Bio/CSA Research Barometers

INSET 1

What precisely does “organic” mean in Europe?

In France, organic agricultural products are legally certified by the Bio Europe label, mandatory since 1st July 2010, in accordance with the specifications in the European regulation (EC no. 834/2007). Despite the fact that the French AB label created in 1985 has been brought into conformity with the European regulation, and is now optional as a result, some products continue to display both labels to reassure consumers. According to the Agence Bio/CSA Research barometer from January 2017, 97% of surveyed were aware of the AB logo, while only 48% knew of the European logo. This share continues to grow, however; previous Agence Bio/CSA barometers found that only 13% of French people knew of the European logo in 2010 and 37% knew of it in 2015. The European specification stipulates:

- products must be 100% organic, or, in the case of processed products, must comprise at least 95% organic ingredients, if the remaining share is not available as organic products and if it has been expressly authorised;
- crops must be grown without synthetic chemicals (fertilisers, pesticides or post-harvest treat-

ments) or Genetically Modified Organisms (GMOs);

- for livestock, feed must be free of chemical pesticides and GMOs (in excess of the 0.9% allowed in recognition of accidental contamination), the use of medications and veterinary treatments must be limited, and the animals must be given a minimum amount of space and access to the outdoors;
- if both forms of production are used, the organic and conventional crops must be separated in both time and space to avoid contamination.

However, for more hardline proponents of organic agriculture, its principles go beyond the current legal requirements. For them, organic farming also involves ecological, ethical and social principles such as prioritising the local economy, short supply circuits with no middlemen, limiting the size and density of livestock operations, sharing revenue more equally, and employee well-being.



This rapid growth took place between 2012 and 2014, a period in which a quarter of all French people began to consume organic foodstuffs. While the proportion of households that consumes organic agricultural products has increased only modestly since then, French consumers have significantly increased the frequency of their purchases. Most households regularly consumed these products: 69% did so at least once a month in 2016, compared to 59% in 2014 and 44% in 2012 (see *Chart 2*). The number of daily consumers of organic products rose significantly in 2016, demonstrating the extent of this phenomenon.

Growing interest from households drove an increase in the market for organic products over the past few years (see *Chart 3*). Following a relatively slow period, sales for the sector saw double-digit growth starting in 2014, topping seven billion euros in 2016⁵. This trend held in the first half of 2017, with sales showing an increase of 14% over

3/ Results of the Agence BIO/CSA Research Barometer, January 2017. The *Agence Bio* is a French national body of professional actors both public (including French Ministry of agriculture for example) and private ones; dealing with organic agriculture and organic products issues.

4/ 54% of French people consumed an organic product in 2003 according to the first edition of the Agence BIO/CSA Research Barometer.

5/ Includes institutional catering (€229 M) and commercial restaurants (€182 M). At-home consumption stood at €6.7 B in 2016.

the first half of 2016 for an additional 500 million euros. If the trend continues for the rest of the year, the market for organic products is set to pass the eight-billion-euro mark. Despite accounting for a relatively modest share of the total food market, organic consumption saw its market share increase by more than half between 2013 and 2016 (from 2.3% to 3.5%).

The boom in the market for organic products is part of a larger trend towards responsible consumption from households. Cognisant of public health and environmental issues, households are increasingly demanding when it comes to the quality and sourcing of the products they consume. According to the latest opinion survey published in January 2017⁶, the growing demand for organic products stems from four main motivations⁷ which are, in order of importance: protecting their health, protecting the environment, the quality and taste of the products, and the safety guaranteed by the product certification. These are just some motivations driving a growing number of French people, who seem to be increasingly committed in their consumption patterns, to consume organic products regularly or occasionally.

According to the same survey, 96% of consumers of organic products intend to maintain or increase their purchases. The robust demand for these products is expected to continue over the next few years. Given this backdrop, how can the supply in the sector evolve to meet this demand, especially in France?

Supply is struggling to keep pace with robust demand

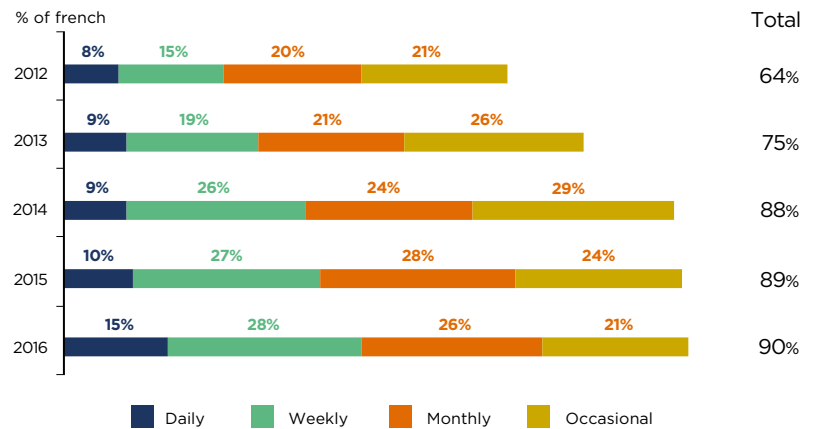
Organic agricultural production has evolved in a cyclical manner over the past decade, alternating periods of stagnation with strong growth, in terms of the area used for this type of agriculture. While the size of the sector had previously remained relatively limited, conversions⁸ to organic production increased significantly between 2009 and 2011 (see *Chart 4*), largely due to the fulfilment of commitments made during the Grenelle Environment

6/ Results of the Agence BIO/CSA Research Barometer, January 2017.

7/ These four motivations were all mentioned by more than half of the households surveyed, with 66% mentioning the idea of protecting their health. Ethical and/or social motivations and concerns for animal well-being – much higher from 2014 onwards – were ranked next, mentioned by around 30% of the respondents.

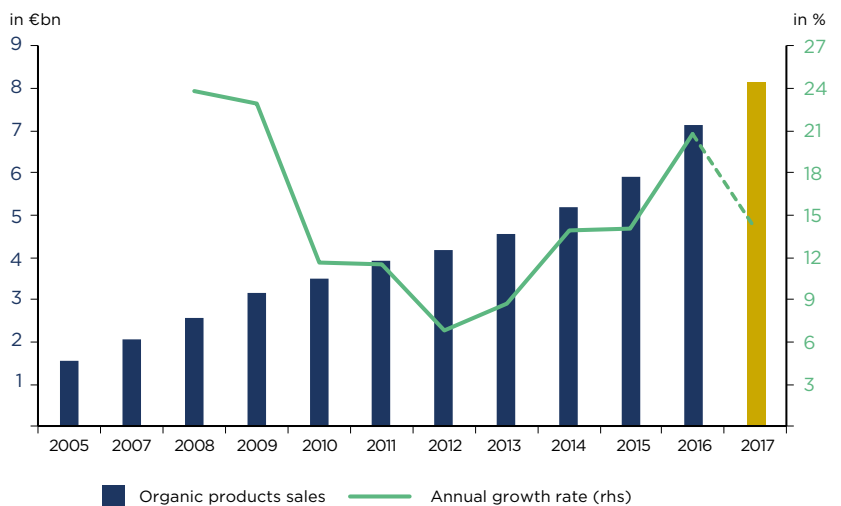
8/ The transition from conventional agriculture to organic agriculture involves a «conversion» phase, during which the producer implements a production method that complies with the rules for organic production without, being authorised to market the products with the organic label. This transition, called the «conversion period», varies depending on the type of agricultural production. For crop production, this period lasts two years for annual crops and grasslands, and three years for perennial crops such as grapevines or orchards. With regard to livestock production, the period may last from six weeks for laying hens to one year for cattle. As a result, it is necessary to distinguish in-conversion areas from entirely converted areas, as the former cannot be used to meet the demand for organic products in the short term.

Chart 2:
Organic products consumption frequency



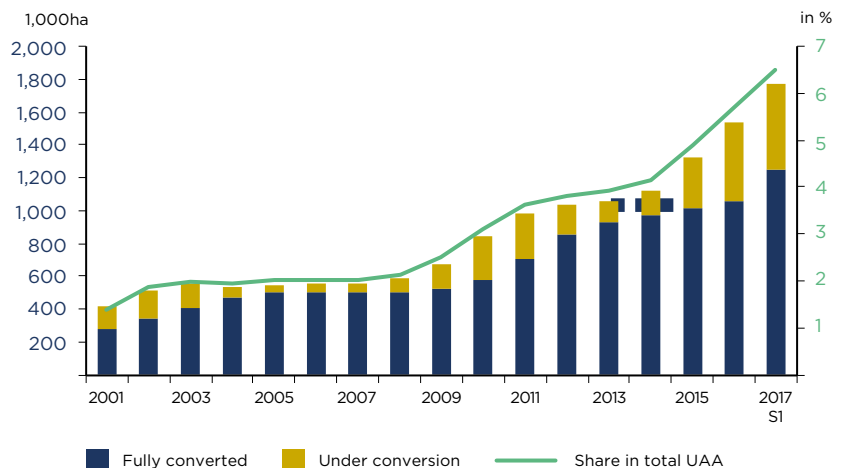
Source: Agence Bio/CSA Research Barometers

Chart 3:
Organic market



Sources: AgenceBio, Coface estimate based on H1 2017 results

Chart 4:
Organic area



Source: AgenceBio

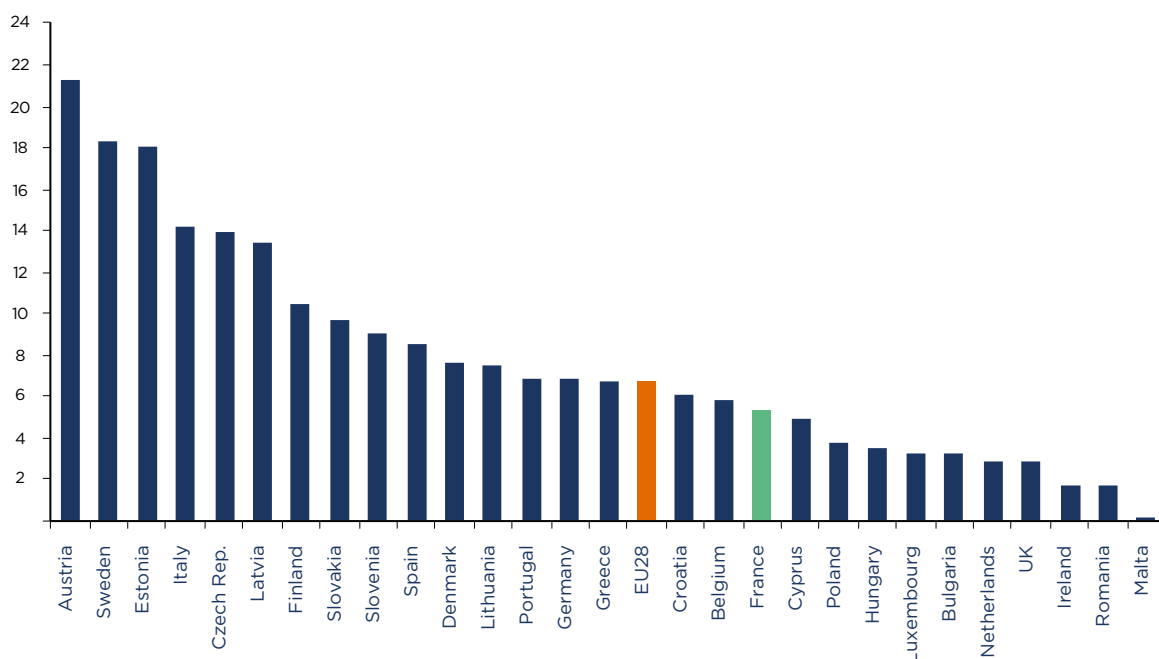


Forum⁹ and increased support from the government. Growth in the sector was driven by a set of measures and support mechanisms instituted by the government between 2007 and 2013 as part of the Rural Development Programme co-funded by the EU: subsidies for conversion and maintenance, tax credits (established in 2006 and doubled in 2009) and structural funds for the sector. Conversions then entered a period of stagnation from 2011 to 2014, before skyrocketing in 2015; in 2017, conversions exceeded 500,000 hectares. Accordingly, although the share of areas cultivated for organic production remains relatively modest, it has increased over the past few years to stand at 6.5% of total utilised agricultural area (UAA) by the end of the first half of 2017. This share remains well below the 2016 European Union average, and

significantly behind that of the Baltic countries, the Scandinavian countries and Austria (see Chart 5).

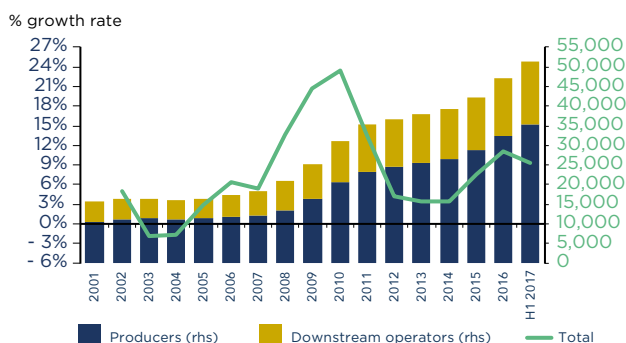
Unsurprisingly, the number of players in the organic sector has followed the pattern set by the conversion phase, with a considerable increase in the number of producers and the number of downstream players – processors, retailers, importers and exporters – between 2009 and 2011, followed by a relative slowdown and a subsequent recovery from 2015 onward (see Chart 6). Thus, while supply outpaced demand in 2011 and 2012, thanks to the wave of conversions begun between 2009 and 2011, supply growth from that point on was significantly less dynamic (see Chart 7). According to *Agence Bio*, consumption of organic agricultural products may have been hindered by a lack of supply in the

Chart 5:
Share of total organic area in 2016 (% of total UAA)



Source: Eurostat

Chart 6:
Organic sector operators



Source: AgenceBio

9/ The Grenelle Environment Forum, hosting representatives from the French government, NGOs invested in environmental issues, social partners and local communities, was held from 6 July to 25 October 2007. Following this forum, the laws implementing Grenelle 1 and 2 were passed in 2009 and 2010, respectively.

first half of 2017, particularly in the milk, salmon, as well as fruits and vegetables segments.

While the pace of new conversions between 2014 and 2016 is expected to lead to a supply increase in the coming years, consumption trends are such that the sector will be forced to change by increasing yields and scaling up production. If it fails to do so, it will find itself relying more on imported products, as it did in 2016, for the first time in seven years.

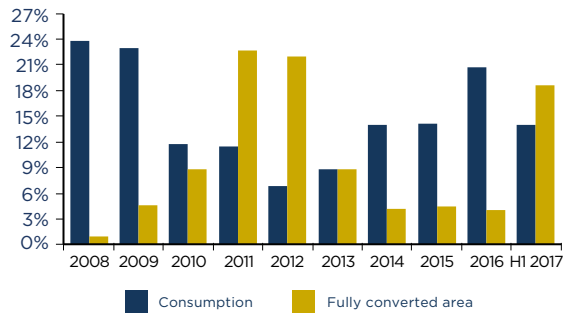
A growing share of imported organic products in France since 2016

Imports of organic products are generally divided into three categories:

- exotic products from tropical or equatorial regions, such as coffee, tea, cocoa, pineapples or sugar;
- products like olives or certain citrus fruits, coming mainly from Mediterranean countries due to their propitious climate;
- goods produced in France, but in insufficient quantities, such as grains, dairy products, meat, or temperate fruits and vegetables.

While imports of exotic or limited-availability products in France are inevitable due to the climate, imports of products that could be grown in France are the result of a demand that has outstripped the locally available supply.

Chart 7:
Supply and demand for organic products

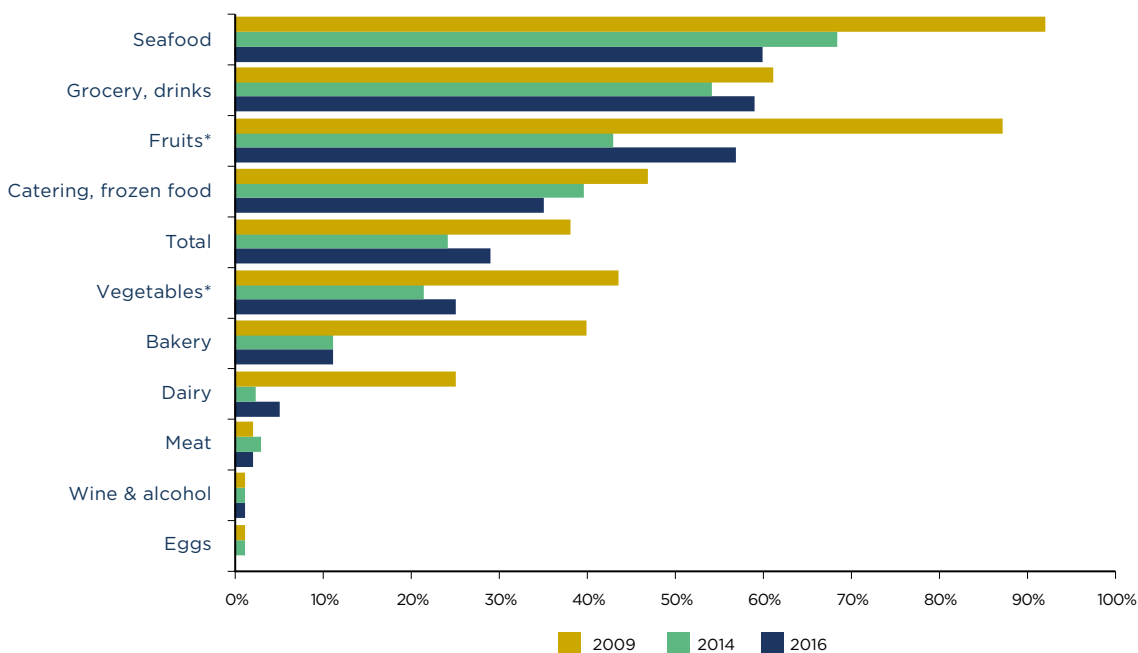


Source: AgenceBio

The share of imports dropped, logically, between 2009 and 2012, going from 38% to 25% of the organic products consumed, following the previously mentioned supply increase. The fruit and vegetable, dairy, and bakery (grains) segments saw their share of imported products drop by 20 to 30 points during the period (see Chart 8). While the fruit and vegetable segment includes exotic produce, products in the dairy and grains segments are widely cultivated in France. Furthermore, if we assume that consumer preferences remained constant and the percentage of exotic products remained stable, then this drop in the share of imported fruits and vegetables can only be explained by an increase in the supply of fruits and vegetables produced in France.



Chart 8:
Imported share by product



Sources: AgenceBio, Coface estimate

* Coface estimate for 2009, from the data "fruits and vegetables" not available separately.



However, after holding steady at around 25% over the next four years, the share of imported goods rose again in 2016, for the first time since 2009, to 29%. The increasing share of imported fruits and vegetables resulted from the fact that growth in the local supply lagged behind demand in previous years. Imports of products that are theoretically available in France – i.e. excluding exotic products – accounted for 57% of total inflows, or 19% of total consumption.

The slight rise in the share of imported dairy products in 2015 and 2016 can be attributed in large part to the crisis in the French dairy industry during the period, and a significant rebound in production is

expected in the coming years, following the wave of conversions begun in late 2015. Meanwhile, in their half-year report from September 2017, the Agence Bio emphasized the need to increase the commitments and production in specific non-exotic segments, such as field crops, vegetables and meat, in order to “keep pace with demand and changes in the scale of organic production”.

As a result, while 85% of households are interested in purchasing locally produced organic goods, extremely dynamic growth in the sector presents a challenge in terms of local supply and short supply circuits, values that are integral to organic production.

INSET 2:

Interview with Florent Guhl, director of the Agence Bio

The market for organic agricultural products is particularly dynamic these days. Can French production meet the growing demand from consumers?

The supply of organic agricultural products has sometimes outstripped demand, for instance when the public incentives policies were instituted between 2009 and 2011 following the Grenelle Environment Forum. However, since 2014 the market for organic products has experienced double-digit annual growth (22% in 2016) and is now outpacing supply. This trend continued in the first six months of 2017, with 14% growth in consumption of organic products. For the first time, growth in consumption was actually constrained in certain segments due to a supply shortfall.

Given the rapidly expanding market, it seems that yields and produced volumes will need to be increased. How can this be accomplished?

We are strongly encouraging organic farms to expand; this will benefit yields and product quality, which are better if the surrounding land is also cultivated according to the organic method. While it is important for these farms to remain at a reasonable

scale, some expansion is necessary. Additionally, the use of technology (sensors and automation) is a divisive issue in the organic community, and yet it helps compensate for the lack of synthetic chemicals, while also ensuring sufficient yields.

Many organic producers have spoken out against the elimination of farm maintenance subsidies, fearing that this will further limit local supply and lead to even more imports in an effort to satisfy the growing demand. What is your take?

This measure is causing concern in the sector, given that it does not seem to be mature enough to transition from public funding to market-based regulation. While organic agriculture has great potential, it still only accounts for 4% of the French food market and is thus vulnerable to economic downturns. Market-based regulation would incur many risks, including opportunistic and unsustainable conversions, major price hikes and an increased reliance on imported products.

2 THE FOUR KEY FACTORS FOR TRANSFORMING THE ORGANIC SEGMENT

Rising consumption of organic products will trigger a dimensional shift in the sector. The shape of this transformation will largely depend on four key factors: the sector's ability to innovate; increases in economies of scale from producers; structural changes within the distributors landscape; and funding for the sector, either from the continuation of public subsidies or through market-based funding.

Innovating to increase yields while complying with environmental standards

The lack of synthetic chemicals and the use of free-range farming practices causes the yields for cultivated areas in organic production to be lower than those for areas cultivated for conventional agriculture. According to studies conducted on the topic, the average difference is between 19% and 25%^{10, 11}, and can exceed 30% for crops such as grains¹². Areas cultivated for organic agriculture tend to be more vulnerable, due to the lack of GMOs and synthetic chemical pesticides that help mitigate threats, such as diseases, and boost yields.

As a result, while innovation is useful in any sector, it is even more so for the organic sector, as it compensates for these vulnerabilities by employing precision agriculture, which makes regular and detailed crop monitoring possible.

Sensors can be extremely helpful for production decision-making. For instance, sensors can be used to monitor disease and rodent risks, making it possible to anticipate issues and save precious time, which can make all the difference in salvaging certain harvests¹³, while other tools like moisture-tracking sensors help manage irrigation. As part of a resource-optimisation strategy, the ability to measure water stress and calculate water requirements represents a significant step forward. Smart weather stations also help anticipate and adapt irrigation and, more generally, determine the optimal time to treat, gather or harvest crops. Calving detectors, which deliver alerts when a cow gives birth, or level detectors for grains, seeds, powders or animal feeds in silos can also improve working conditions and efficiency.

For retailers, technology can simplify logistics, as it is the case for the *La Ruche qui dit Oui !*, a business initiative that promotes short supply circuits by circumventing middlemen and bringing consumers and farmers together. Consumers order online from a list of products from the closest *Ruche* partner producers, then visit the distribution site at a certain date and time to pick up their purchases. Consumers are thus able to buy local products with short supply circuits (both organic and conventional), as *Ruche* commits to selling only products that were cultivated or processed within a 250-km radius.

While many similar local initiatives have been established by non-profits, *La Ruche qui dit Oui !* is the only organisation with a national, and now pan-European, footprint. Six years after opening the first *Ruche*, this start-up now boasts over 1,500 similar entities, over half of which are in France; the rest are located in Italy, Belgium, Germany, Spain, Switzerland, Denmark and the Netherlands. Technology has become the sine qua non for scaling up and reducing logistical costs.

Producers will probably have to expand their farms to generate economies of scale

Due to more modest yields, organic agriculture requires more labour on average: in 2013 there was a twofold difference in cultivated area per annual unit ■ ■ ■



While innovation is useful in any sector, it is even more so for the organic sector, as it compensates for these vulnerabilities by employing precision agriculture.



10/ "The crop yield gap between organic and conventional agriculture", T. de Ponti, B. Rijk, M. K. van Ittersum, April 2012.

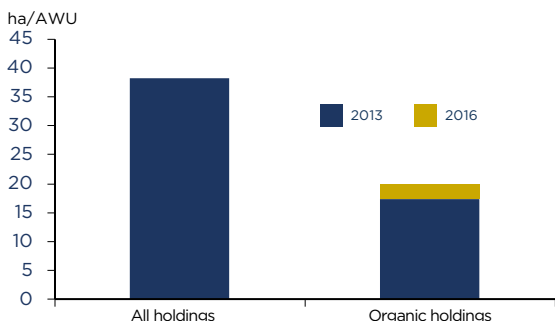
11/ "Can organic crops compete with industrial agriculture?", C. Kremen, December 2014.

12/ "Comparing the yields of organic and conventional agriculture", V. Seufert, N. Ramankutty, J. A. Foley, April 2012.

13/ For instance, in viticulture, there is an innovative sensor that can detect the first variations in colour indicating *flavescence dorée* disease has taken hold, resulting in faster treatment. The colour change that is a symptom of this disease can only be detected by the naked eye when the damage is already quite advanced, at which point the vines must be torn out.



Chart 9:
Area per annual work units (AWU)



Sources : Agence Bio, Eurostat (*Enquête structure 2013*)
* Annual work unit : work performed by one person who is occupied on a full-time basis

of work (see *Chart 9*). Thus, a year's worth of full-time work would be needed to cultivate 17 hectares, compared to the agricultural sector average of 38 hectares.

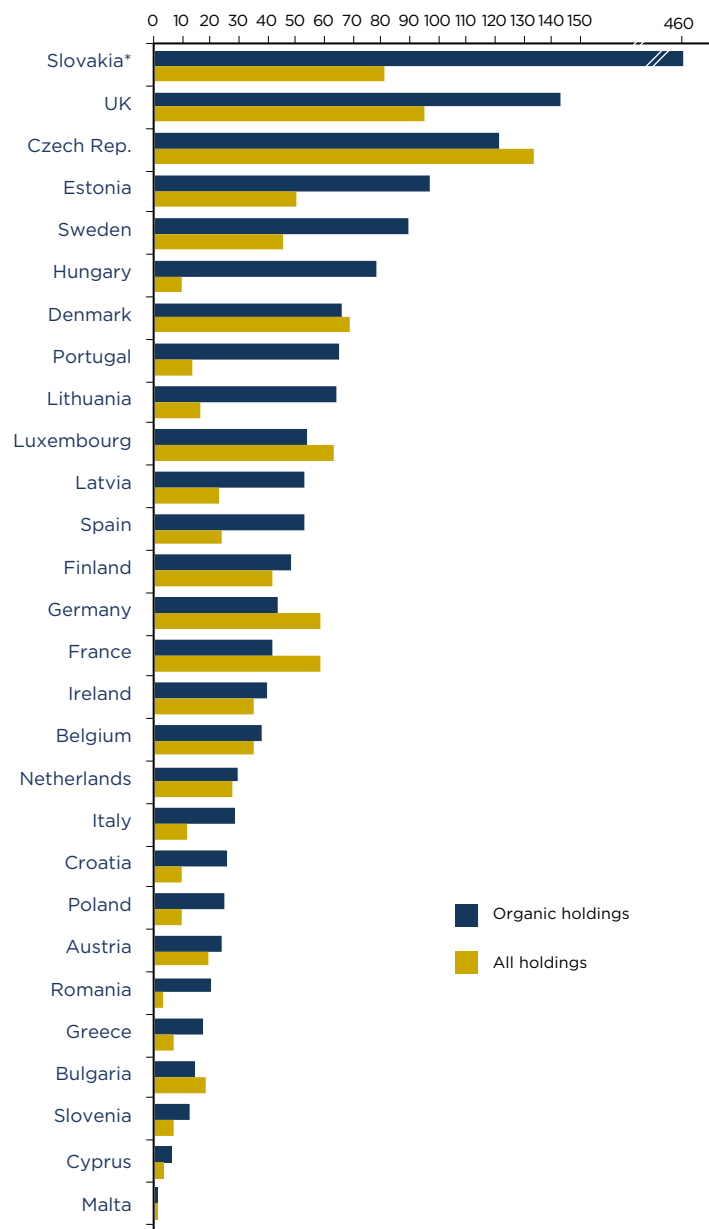
While the productivity of organic agricultural cultivation increased between 2013 and 2016 (the cultivated area per annual unit of work rose to 20 hectares), it remained well below the level for conventional production. While being more labour-intensive can be positive, given that more jobs are created when the sector expands, it also represents a drawback in terms of profitability. As a result, increasing yields for operations is a critical priority for satisfying the growing demand.

Whether it is possible to increase the local supply of organic products will be determined by the number of new producers involved, as well as the size of their agricultural exploitations. Structurally speaking, organic farms in France are smaller than average (see *Chart 10*). This is especially significant in light of the fact that the share of permanent grasslands is much greater for areas cultivated for organic agriculture than for the agricultural sector as a whole (see *Chart 11*); this means that the size of organic operations tends to be overestimated.

This can be understood as an effort on the part of organic agricultural producers to remain at a reasonable size, in contrast to the more industrialised agriculture in the conventional segment. This is not necessarily the case in the rest of the European Union, where organic farms in many countries are larger than in the rest of the industry (see *Chart 10*).

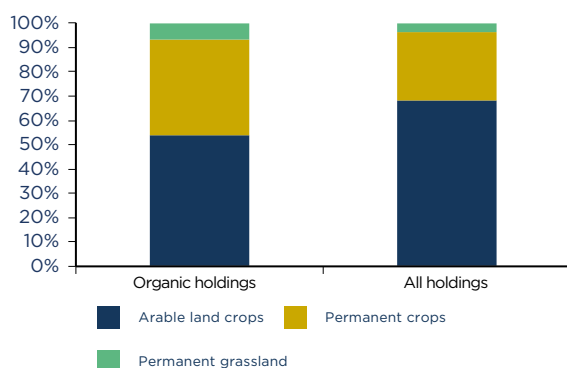
However, most of the countries with organic farms that are larger on average than those in France have a greater share of their utilised agriculture area being used as permanent grasslands. Thus, farms in France are not especially small compared to their European counterparts, except in the case of the Baltic and

Chart 10:
Average size of organic holdings



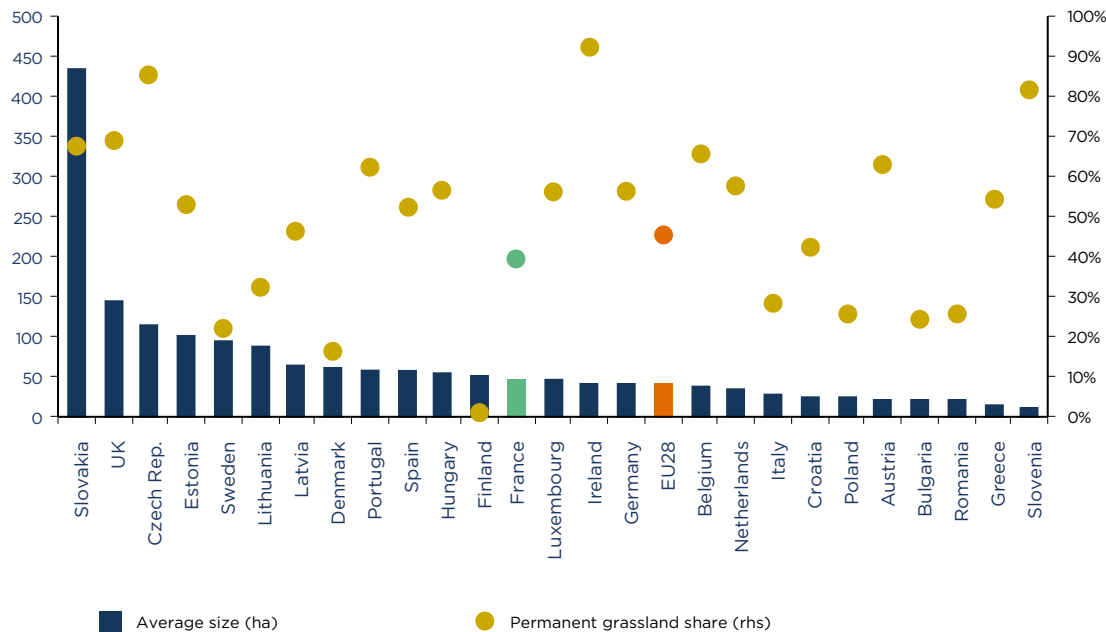
Source: Eurostat - Latest data available: 2013
* Average size of organic holdings in Slovakia in 2013: 460 ha

Chart 11:
Distribution of total utilised agricultural area by crop types in 2016



Sources: Agreste, Agence Bio

Chart 12:
Average size of organic holdings and permanent grassland share in 2016



Source: Eurostat - Latest data available: 2016

Scandinavian countries (pioneering regions when it comes to organic agriculture), whose operations are larger on average, despite having a comparable or smaller grassland ratio (see *Chart 12*).

In addition, when our data analysis compared changes in insolvencies in each sector with the proportion of organic operations in these sectors, the organic farms were found to be in good financial standing (see the *“Organic Share and Insolvencies” inset*).

Despite the reluctance of certain players, who fear that the concept of organic agriculture will be degraded by industrialising production, the expansion of farms seems inevitable, given the growth in the sector. Such an expansion would make it possible to increase yields through economies of scale, and improve product quality while limiting risks of contamination by chemicals from surrounding fields.

In addition, as The Agence Bio notes, the sector is dealing with significant logistical costs due to farm fragmentation¹⁴. For the moment, the sector is suffering from a relative lack of organisation¹⁵, a common issue for new sectors, although a few initiatives are making great strides in this area.

The Biolait cooperative, established in 1994 by six livestock farmers from Morbihan and Loire-Atlantique in an effort to pool production and ensure that certain isolated farms could remain viable, currently comprises nearly one-third of the producers – and volumes – of French organic milk. With pooled production initiatives like this one, logistical costs are reduced, production in the most

challenging regions becomes viable, and the collective bargaining power of producers is strengthened. The ability to negotiate the selling price on behalf of all members, and for considerable volumes, places their negotiations with downstream players on a more equal footing.

Organising more collective approaches like this one to optimise flows will be critical for increasing profitability for producers and rendering isolated farms economically viable by ensuring that all members are compensated at the same rate, regardless of their geographic location.

Towards increasingly more concentration within the organic retail actors

The landscape of French organic retailers is highly diversified. The main groups are established retailers in the organic agrofood sector, either as independent entities or in networks, and conventional players such as large retailers.

Networks of specialised shops (such as *Biocoop*, *Bio C’Bon*, *La Vie Claire* and *Les Nouveaux Robinson*) are generally found in larger cities. The *La Ruche Qui Dit Oui!* company is a sort of hybrid, combining

14/ “As the supply of organic agricultural products is often fragmented, partnerships between producers and processors include joint planning for varieties and quantities, amongst other things, in order to minimise the environmental and economic impact of the supply chains.” www.agencebio.org/des-filieres-durables-et-innovantes, as at 30/11/2017.

15/ “These attempts to structure the sector (...) are just a few of the levers driving the development of organic agriculture in France.” www.agencebio.org/des-filieres-durables-et-innovantes, as at 30/11/2017.



significant contributions from volunteers, “active consumers”, members, and occasional or regular contributors with product distribution. *La Louve*, a cooperative, inclusive supermarket owned and managed by its customers, represents another innovative structure. The community-supported agriculture non-profit networks (known as *AMAPs* in France) are also unique, in that their initiatives are spearheaded by consumers who pay in advance for all their organic agricultural products directly to the producers, in order to support them. In addition to promoting short supply circuits, *Les Paniers Val de Loire* also has a social mission, working through

seven community gardens to provide work for people with challenging employment situations.

The boom in the organic products market represents an incredible opportunity that conventional players are looking to seize. The mass retail sector, despite a longtime presence on the organic market, has doubled its efforts over the past few years in order to increase its market share. Sector players, who are worried about falling into the same pattern of dependence on mass retail that exists in conventional agriculture, have expressed their concerns. However, the interest of mass retailers (*Carrefour*,

INSET 3

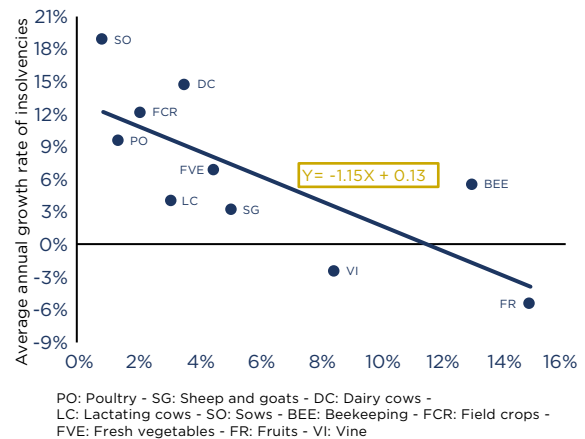
Organic share and insolvencies

In France, activity in the organic sector has translated to a relative reduction in insolvencies compared to players in conventional agriculture. While in the agrofood industry insolvencies grew by 4.9% per year between 2012 and 2016 period, the sectors (such as fruits, wine grapes, beekeeping, or sheep and goats) that have had a larger share of organic agricultural production since 2012 had fewer insolvencies in the period than those with a smaller proportion of areas (or heads for flocks) used for organic production (see *Chart 13*). The sectors of field crops (grains, oil seeds or protein plants), poultry farming, pork and dairy cows, which have not converted to organic production in large numbers, saw greater increases in insolvencies over the same period. From this Chart we can see that a 10% increase in the share of organics is associated with an 11% decrease insolvencies.

This correlation is supported by our use of the exploratory PCA technique (principal component analysis). Based on the results, we found a negative correlation between the share of organic production (green dots) and the increase in insolvencies (yellow dots), their vectors (green and yellow arrows) having opposite directions with respect to the coordinate axis, except in 2015 (see *Chart 14*). Additionally, while the changes in insolvencies for each sector by and large resulted from price fluctuations and disturbances that affected each sector independently from 2012 onwards, it seems that, all things being equal, the sectors that converted to organic agriculture to a greater extent were more resilient over that period. These observations are consistent with the fast-growing market for organic products, which has translated to major opportunities in the past few years.

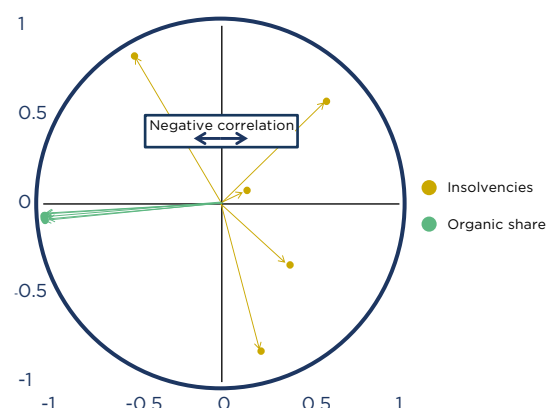
Principal component analysis is an exploratory statistical technique that is used to obtain commonalities from correlated data. These commonalities reveal a hidden structure within the original data set, facilitating the process for grouping data and observations. In our case, this method seemed the most appropriate given the limited number of observations available to us. It is the most robust option, given that unlike linear regression, it does not rely on probabilistic hypotheses, and thus does not require as many observations.

Chart 13:
Share of organic production and insolvencies between 2012 and 2016



Sources: AgenceBio, Coface

Chart 14:
PCA exploratory data analysis of insolvencies and organic production share



Leclerc, Intermarché, Casino and Auchan) in this market is not a new phenomenon. They all began by launching their own organic brands: *Monoprix Bio* (*Casino*) in 1994, *Bio village* (*Leclerc*) and *Casino Bio* in 1999, *Carrefour Agir Bio* in 2005 and *Auchan Bio* (2006). The market share for supermarkets was close to 40% in 2005, and continued to increase through 2011, topping out at 49% (see *Chart 15*).

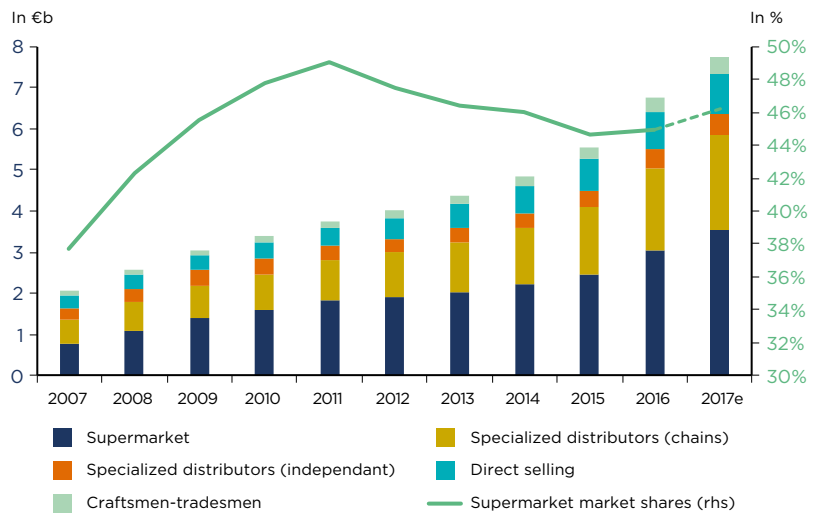
Starting in 2012, the trend began to reverse itself, shifting in favour of specialised networks of retailers. Thanks to a particularly aggressive expansion strategy, these retailers saw their sales grow at a much higher rate than supermarkets between 2012 and 2015. While supermarkets experienced a slower increase in sales than the market as a whole and independent specialised retailers suffered through a lacklustre period, networks of retailers drove sector growth between 2012 and 2015 (see *Chart 16*). As a result, while the combined market share for supermarkets and networks of specialised retailers remained steady at around 75% from 2011 onwards, there has been an undeniable shift towards a new balance of power. In 2016, the market share for supermarkets was 45% (-4 points), versus 30% (+5 points) for networks of specialised retailers (see *Chart 17*). The remaining sales in the market came mainly from direct sales (13% market share), a retail method that consistently outperformed between 2011 and 2015.

It is difficult, however, to rule out the possibility of a significant breakthrough for the main mass retailers in France, as they still hold considerable sway over the French market. The example of the rapid expansion of hard discount brands (like Lidl, Aldi and Dia), who opened the mass retail industry in the 1990s and 2000s with their business model based on a limited selection of extremely inexpensive products, is quite telling. The market share for hard discount stores was 14% in 2009; it has since shrunk, and the leader in the segment, Lidl, has even announced an intention to abandon this strategy and move upmarket. Unlike in Germany, where the market share for hard discounters is still hovering near 40%, the strategy was abandoned in France in large part because of the incredible adaptability of the largest mass retailers, who segmented their ranges and launched their own lines of discount products.

The firepower of mass retailers is considerable and most have updated their strategies over the past few years, opening fully organic stores as a reaction to the shrinking market share of supermarkets in the market for organic products from 2011 onward.

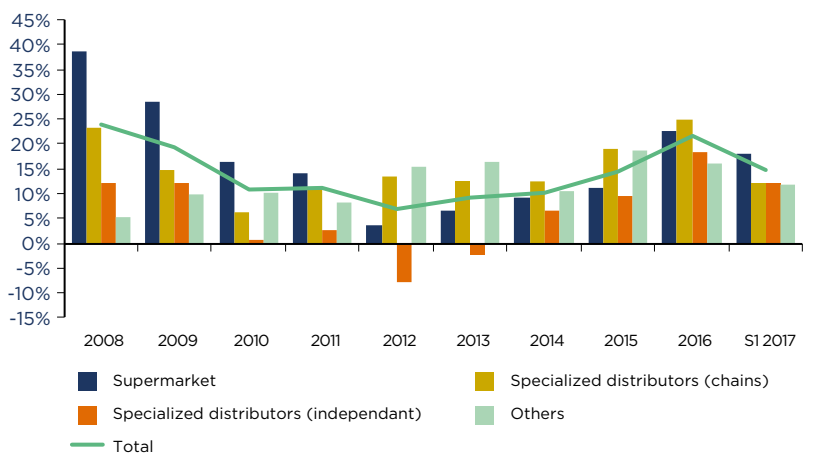
That is how Auchan, who opened their first fully organic store - *Cœur de Nature* - in 2012, came to open the flagship Auchan Bio store in November 2017. Carrefour, which has opened fifteen *Carrefour Bio* stores since 2013 and aims to open ten times more by 2021, has been particularly aggressive, going so far as to acquire the top website for organic products, Greenweez, in 2016. While *E. Leclerc* is still primarily focusing on growing their *Bio Village* line, they also opened an "organic/Italian" store in

Chart 15:
Sales by distribution channel



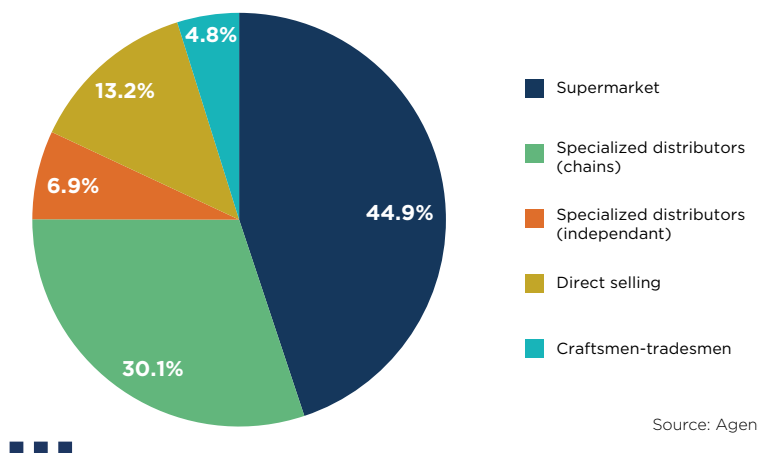
Source: Agence Bio

Chart 16:
Sales annual growth by distribution channel



Source: Agence Bio

Chart 17:
Market shares by distribution channel in 2016



Source: Agence Bio



June 2016. *Naturalia*, acquired by *Casino* – through *Monoprix* – in 2008, is an intermediate case, being a network of specialised retailers that is owned by a mass retailer. Since the acquisition, *Naturalia* has grown from 38 points of sale to over 150.

Carrefour and *Leclerc* have both stated that their aim is to become the largest organic retailers in France and ensure that their products are 20% to 30% less expensive than those of specialised retailers. In addition, supermarkets saw their market share increase in 2016 for the first time since 2011, thanks to a marked acceleration in growth, more than doubling to 22.5%. This momentum continued in the first half of 2017, with supermarkets reporting an 18% increase in year-on-year sales, compared to 12% for specialised retailers as a whole¹⁶. Although this data is not sufficient to predict the orientation of the organic products market over the coming years, it is impossible to rule out the possibility that their expansionist strategies could yield a significant increase in the market share for supermarkets. Confronted with this potential upheaval, established networks of specialised organic retailers could join with other players to generate economies of scale and provide a coordinated response to the growing dominance of mass retailers.

This sort of transformation would constitute an opportunity for the organic agriculture sector, accelerating its growth and popularity by enabling new consumers and occasional purchasers to access organic products. On the other hand, there is the possibility, though still remote¹⁷, that the market for organic products will follow in the footsteps of consumer products, where the combined market share for the six main companies (*Leclerc*, *Carrefour*, *Intermarché*, *Casino*, *Système U*, *Auchan*) hovers around 90%. If this were to happen, the sector's highly dependent position would be a significant risk factor.

This sort of dependence would likely result in an arrangement like the one that currently exists in conventional agriculture, with significant downward pressure on prices for industrial players and, ultimately, producers, due to the imbalance of power

in negotiations. Furthermore, as supermarkets are much less committed to the cause than networks of specialised retailers¹⁸, the organic agriculture sector could become reduced to its strictly legal form, degraded by losing some of its founding principles like short supply chains, small carbon footprints, community roots, and fair distribution of the value created.

In addition to the eventual structure for the sector and its main players, organic agriculture is also facing a sizeable challenge in the medium-term: transitioning from a model that is largely dependent on government subsidies to market-based funding.

The market-based remuneration issue

Government subsidies¹⁹ for organic agriculture – which are meant to compensate for the higher costs and loss of earnings associated with this production model compared to conventional agriculture – are divided into three main categories: conversion assistance, maintenance subsidies, and tax credits.

The purpose of the maintenance subsidies is to maintain the production potential of organic farmers whose fields have already been converted. It takes up where conversion assistance leaves off, and is paid out over the first five years. On average, it provides around one-third less money than the conversion assistance. The individual amounts of these subsidies vary depending on the size of the operation and the type of crop, in light of the fact that the loss of earnings compared to conventional production differs from one crop to the next. The 2015-2020 Rural Development Programme had set the total amount for these subsidies at 160 million euros per year. However, the uptick in conversions in 2015 and 2016 forced the government to allocate additional funds.

The announcement last September that the government would be phasing out the maintenance subsidies as of November 2018 spurred an outcry amongst sector players, who felt that this decision demonstrated a lack of support for production, at a time when some segments are struggling to become self-sufficient. The government has left it up to the regions to use their own funds to continue these subsidies, and if they decide not to do so, the loss of revenue for producers could amount to between 30 and 50 million euros, according to



The firepower of mass retailers is considerable and most have updated their strategies over the past few years, opening fully organic stores.



16/ Sales growth data was only available for specialised retail as a whole in the Agence Bio half-year report, with no distinction between networks and independent stores.

17/ Assuming that retailers will see the same growth as in the first half of 2017 (supermarkets: +18%, specialised retailers: +12%, direct sales: 11% and artisanal producers: 14%), the market share for mass retail would reach 50% in 2020, 60% in 10 years, 70% in 20 years and 80% in 30 years.

18/ "Our aim is to bring organic products to the masses with a more open, less dogmatic approach than the specialists," Richard Vavasseur, Director of Premium Brands for Carrefour, *Comment Carrefour compte s'emparer du marché bio*, 16/03/2016, LeFigaro.fr.

19/ Some regions have also implemented their own financial assistance schemes.

the national organic agriculture federation (FNAB). While government funding, strictly speaking, only amounts to between six and eight million euros per year in the form of maintenance subsidies, the payment of European Union subsidies is conditional upon a minimum of 25% funding by national governments, so the loss of the French subsidies would also trigger the end of European aid.

The government did announce in November 2017 that it would extend the organic farming tax credits through 2020 and increase the amount from 2,500 to 3,500 euros as part of an amendment to the 2018 budget. While this affects farmers who are in the process of converting as well as those who have already done so, this measure can be seen as attempt to offset the loss of the aid, as it will primarily benefit the producers affected by the termination of the maintenance subsidy, due to a cumulative maximum benefit of 4,000 euros. While producers active in organic agriculture will see their aid increase from 2,500 to 3,500 euros, most producers that receive conversion aid will reach the cap without benefiting from the maximum amount of the tax credit. The tax credit, available to operations which derive at least 40% of their revenue from organic agriculture, was instituted in 2006, extended and doubled as part of the Grenelle Environment Forum in 2009, and then extended for additional three-year periods in 2011 and 2014.

The question at the heart of these political decisions is how organic agriculture should be funded, and when is the right time to transition from a publicly subsidised model to market-based funding. The main argument proffered by the government and organisations which support market-based funding, including the national federation of farm workers' unions (FNSEA), is the strong growth in demand for organic products. According to many sector players, however, market-based funding would require a mature, stable market; otherwise, it would be vulnerable to market fluctuations, especially if demand were to shrink.

The issue of profitability for those involved in organic agriculture is a central one, in that if market-based funding takes hold, there will have to be some compensation for the loss of revenue from the termination of public aid, either by increasing yields or by raising prices. That being said, any price hike would incur the risk of pushback from consumers, and thus retailers, as is the case in conventional agriculture. This would likely result in the sector



Can organic agriculture shift from a publicly subsidised model to market-based funding?



adopting the same value-sharing model used in the conventional sector.

Funding for the organic sector raises the issue of compensation for positive externalities. For its defenders, it is necessary to provide remuneration for the environmental and health benefits of organic agriculture and, at the same time, to subsidise the price of organic products in order to reach a larger swath of consumers – price always being a discriminating factor, as demonstrated by the over-representation of middle and upper classes socioeconomic categories and the under-representation of “labourers” as consumers of organic products²⁰.

For proponents of market-based funding, the organic sector is sure to become profitable thanks to booming demand that is outstripping supply, making it possible to raise prices. This theory also points to the consumer preference for local products²¹. However, for most households this preference comes down to the difference in price between imported products and French ones: a significant price hike in organic products would cause households to turn away from this sector or, more likely, would lead to an increase in imports. A survey conducted by IFOP on behalf of WWF France in October 2017 found that while 69% of French people were willing to pay more so that farmers could earn more, only 33% were willing to pay at least 10% more, and this number fell



20/ “Étude individuelle nationale des consommations alimentaires 3”, ANSES, June 2017.

21/ According to an Opinion Way survey from March 2016, 93% of French people “occasionally” prioritise local products and 63% do so “regularly”. The same survey found that 61% of French people are willing to pay more to support the local economy. The survey did not specify how much more French people would be willing to pay, however.



to 8% if they were asked to pay 15% more. Thus, consumer preferences – whether environmental or social – do not translate to infinite price elasticity.

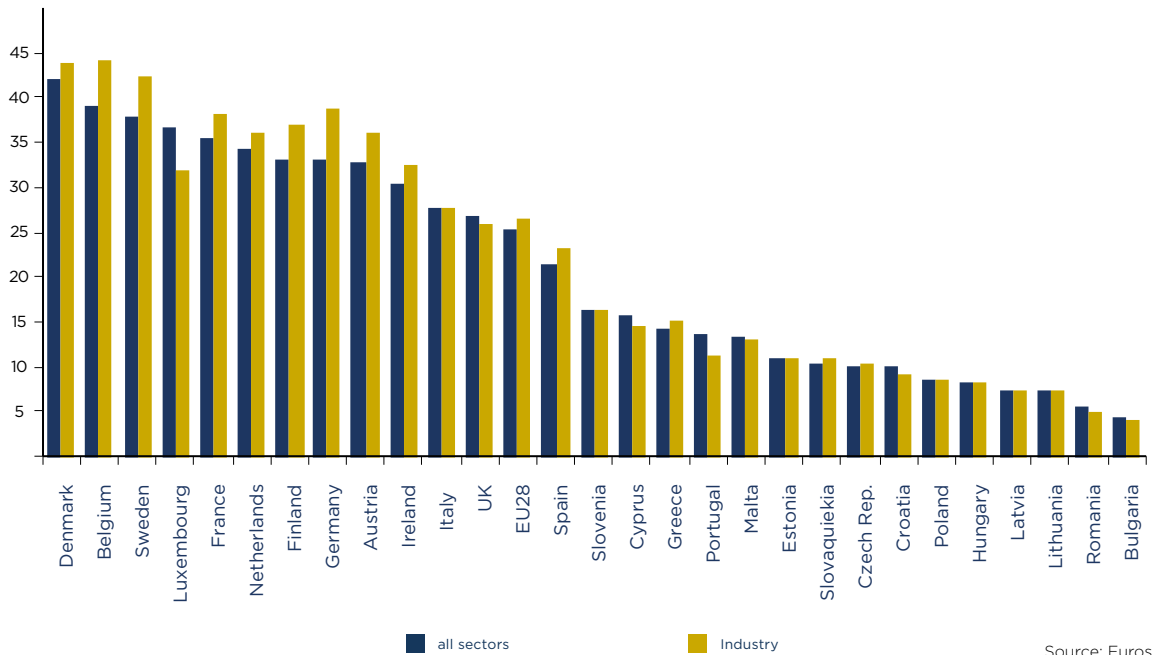
Furthermore, as the organic agriculture sector is particularly labour-intensive – due to the need to compensate for not using chemical pesticides or GMOs – it is much more sensitive to labour costs, which are higher in France than in most European Union countries (see *Chart 18*).

As a result, in the event of market-based funding, and if the sector is not mature enough to be able to

compensate for the loss of revenue with increased yields, then it is very likely that prices for local products will rise and imports of cheap organic products will increase.

The organic agriculture sector would then follow in the footsteps of most other sectors, with a wide-ranging supply comprising all price points that is consumed by most households. But in the process, it would abandon its founding principles of short supply circuits, local production and minimal carbon footprints.

Chart 18:
Average unit labour cost in 2016



Source: Eurostat

RESERVATION

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COFACE SA

1, place Costes et Bellonte
92270 Bois-Colombes
France

www.coface.com