

Full potential not realized yet

HOW IS THE BAKING INDUSTRY STANDING UP IN EASTERN EUROPE 20 YEARS AFTER THE POLITICAL CHANGES AND DURING THE CURRENT ECONOMIC CRISIS? **DR. DANIEL GERBEL** STUDIED BAKING TECHNOLOGY IN MOSCOW BEFORE HE STARTED WORKING FOR DIOSNA GMBH, OSNABRÜCK, GERMANY. THE SLOVAKIAN TECHNOLOGIST IS RESPONSIBLE FOR THE MARKETS IN EASTERN EUROPE. BAKING+BISCUIT INTERNATIONAL TALKED WITH THE EXPERT WITH INTIMATE KNOWLEDGE IN THIS FIELD

+ bbi: Dr. Gerbel, after the political changes in Europe, the baking industry in Central Europe also underwent massive changes. Now, the financial crisis is hitting these countries very hard. Does this situation affect the baking industry in these states or is the industry so well established that it can rely on the old adage “people must always eat” so that few sacrifices have had to be made?

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+ Dr. Gerbel: The industry has changed, but in my opinion, the full potential has not yet been tapped. This cannot always be blamed on the bakers. The changes were basically with ownership and not in the way that the customers viewed the baked goods. The people consider bread and baked goods to be an inexpensive and perhaps even cheap staple food and do not see these products as luxury food items or supplements for healthy nutrition. However, the industry has not succeeded in freeing itself from “external” influences of “subordinate” structures. In the past, there were only interventions from the governing party; today, most bakeries are “controlled” in terms of prices and sales conditions by trade chains. The crisis did not contribute to changing these conditions. The baking industry in Eastern Europe does not have the financial or societal power to resist the effects of the crisis. However, I do agree that in the future more staple food will be consumed including bread and baked goods. However, in the last few years, the bakeries have not generated the necessary profits with such products.

However, I am convinced that, for the baking industry, the crisis will be over much faster than for other industrial and economical circles and that this condition will strengthen the position of the bakers. The social and economical attractiveness of the industry will increase as will the availability of workers. I hope and believe that the interest in domestic products, including baked goods, will grow if the quality is right.

+ bbi: How tough is competition amongst the baked goods suppliers in Central Europe? What are the factors? Do these include quality, innovation, new products and new tech-

nologies such as frozen dough pieces or is it predominantly price that is the major factor?

+ Dr. Gerbel: In general, the number of baked goods manufacturers has decreased significantly in this region over the last few years. Many of them did not survive the negative economical development. However, there was a strong consolidation of production sites. The predominant reason for this was not the competitive situation but rather the pressure from the retail chains and the low prices the consumers expected. The real competition takes place outside the bakeries, amongst the retail chains, although they do bring the battle into the bakeries. This is mainly true for the basic product range where the price is the most important factor for success. It is logical that the majority of manufacturers, predominantly the industrial bakers, subject themselves to this dictate. I must apologize to those manufacturers whose priority is top quality; but the number of low quality products that have been on offer over the last few years in the Eastern European shops is unparalleled. Unfortunately, this situation is still ongoing in some regions, despite the fact that





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quality has come into focus, at least, in the economic hotspots. I can totally understand this situation as it is not easy to pay for trained and motivated personnel under these circumstances. Apart from Western countries, technologists and educational institutions have become extinct and, with this, quality has been compromised. Knowledge of production technology which is the road to success will rarely be utilized any more in these countries. We must get back to this situation or otherwise we will, for sure, lose the competition with professional players who will definitely enter these markets one day.

Compared to Western Europe, there are fewer innovative products offered to the consumers in Central Europe, although this tendency is on the increase. I see a lot of potential here, for example, the segment of frozen products is currently the most dynamic sector of all while organic products are still awaiting their opportunity.

+ bbi: Which parts of the industry have been hit the hardest by this type of competition and in which countries? Who are the winners emerging from the new structure?

+ Dr. Gerbel: The industrial manufacturers of bread and baked goods have experienced the highest level of competitive pressure; there is no doubt about that. The industrial production of baked goods is a tradition in Central Europe, where virtually each district capital had its own industrial bakery. This is no longer the case today; their numbers have been reduced dramatically and quickly due to a number of reasons. In Poland, for example, hardly any survived the “successful privatization”. In other countries, their numbers were reduced because of the enormous economical pressure imposed on the production, the consolidation of production capacities and last but not least poor management. Trade chains prefer industrial manufacturers who offer a broad

product range. Up until now there have been no such industrial bakeries with a capacity of 300-400 tons a day as can be found in Western Europe. From this point of view, the market in Poland is interesting because here such centralized production facilities are already emerging. My personal opinion is that Poland is the winner in this region; I would probably find the most positive examples in this country. Poland is significantly different from the other countries not only because of its market size but also because of other aspects. Apart from a few exceptions, industrial bakeries did not survive the privatization and very quickly many hundreds of small private bakeries stepped in and were able to turn themselves into strong companies providing high quality products. This was possible because of the market size and the sound competition. The quality of the baked goods in Poland has been remarkably high for some years now while the prices were and still are above the average of those prices in the adjoining countries. Such a market with attractive prices can of course attract supranational competition much faster as can be seen in Poland. Today, there are some strong domestic and foreign companies active here which have begun to successfully enter other markets with their frozen or par-baked products. The Polish producers of tea biscuits are very well known and these are available in the supermarkets in all of Eastern Europe.

I must also not fail to mention the small and medium-sized bakeries and pastry shops which are the winners having succeeded in setting up their own trade network based on an excellent organization of production and sales activities and that have been able to secure a strong position in the market because of their excellent quality. There are not many of these, but they are there and can be found in every country in Eastern Europe.

+ bbi: Many companies had hoped to act as competitors in Western Europe because of the comparably low wages. This has not turned out to be the case. What is the reason behind this?

+ Dr. Gerbel: There are several reasons, but in my opinion the most important one is the protectionism of the Western markets (a term that unfortunately takes a new shape in the current crisis) and the traditional mistrust that Western consumers have against Eastern European products. There

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were many attempts to succeed in the markets with, for example, gingerbread cookies from Pardubice and bread and baked goods and pastry products from Eastern European producers from the border areas – just to name a few. What is needed is predominantly quality, persistence and financially challenging marketing. However our bakers cannot afford this. The bakers from Eastern Germany as well as the producers of frozen and par-baked products from the ►



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Czech Republic and Poland have already confirmed that success is possible. It is much more uncomplicated to distribute the products via a regional agent as the conservative final consumer in the West has the resulting difficulty of identifying the manufacturer.

+ bbi: What is the financial situation of the companies? How much of their own funds do they have and how much debt? How hard are they being hit by the current financial squeeze?

+ Dr. Gerbel: In general, the bakers in Central Europe are undercapitalized for the reasons already mentioned. After they had paid their debts from privatization, they started modernization. However, the modernization of the production had to wait as the modernization of the roofs of the buildings and heat economy measures were more important. The modernization of production lines and equipment only actually started a few years ago and will not be completed for a long time. In the last few years and, in particular, after credit became cheaper and leasing options were more available, the bakers made use of these financial instruments. Bakers have never been and never will be financial speculators; they are very careful regarding financial operations and financing. This is currently a positive fact. I do not believe that the banks will limit the credit system for too long; it is only a temporary condition. However, I am concerned about the fluctuations and instability of national currency. This impedes the pay back of credit in other currencies and also decelerates investments into modern machines and equipment. We cannot escape this.

+ bbi: Do you anticipate that necessary and essential investments will be postponed or even dropped in the long run?

+ Dr. Gerbel: Sure! We can lay witness to this already. Large proportions of the projects have been halted and are waiting

for better times. For me, it is incomprehensible that there are companies that are canceling their orders under the cloak of the crisis only to turn around and invest in cheaper solutions with the risk of poorer quality and a weakening of their future position. However, I also know customers who have decided to invest right now; they are targeted and quality minded. They understand the multiplying power of this effect in hard times like ours. I have been involved in this industry for more than 20 years and I am still fascinated by the courage and the decisiveness of this type of customer (and there are many of them in Eastern Europe). Often they are market leaders.

+ bbi: What do you think are the largest investment requirements in the different countries by geography and technology?

+ Dr. Gerbel: Of course, the differences between the individual countries are decisive here. Countries such as Romania, Bulgaria and surprising Hungary have in total invested less in machines and equipment than the Czech Republic, Slovakia and Poland. This is where the largest investment potential is, although it is questionable how fast these countries can overcome the crisis of their national currency and the bank sector. In the Czech Republic, Slovakia and Poland, investments will be made in complex technological lines and sometimes in new modern production capacities.

One thing is applicable to all countries – the bakers will invest in the expansion of their own retail chains. This is where the largest potential is – at least in my opinion.

+ bbi: Is there a difference between the individual product groups – bread, frozen, pastries, dry baked goods, crackers?

+ Dr. Gerbel: Investments into the modernization of bread production will continue with the goal of higher production capacities, better automation, more energy savings and hopefully a general improvement of the quality of the baked goods. Currently, the most dynamic demand is in the field of lines for frozen and par-baked products. This trend will increase because there are still many white spots on the markets in Eastern and Central Europe. The portion of such products in these countries is still low compared to Western Europe.

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Regarding the market for dry baked goods and crackers, the die is cast. This market is divided amongst national and international companies determined not to lose their position. These companies do invest from time to time with their target countries being the larger markets such as Poland and Romania.

+ bbi: Is there any investment into automation of controls and energy savings – both may result in cost savings which ►

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may justify the investment? Will credit or even sponsor funds be available for these companies?

+ Dr. Gerbel: Apart from a few cases, there has not been much development in Eastern European countries in terms of automation of control in the production of baked goods. The exceptions are lines for small baked goods in the Czech Republic, in Slovakia and Poland as well as some bread and toast bread lines in these countries and in Hungary. However, in general, little has changed in the automation of technological production processes for bread and fine bakery wares, in the automation of packaging processes, in the distribution of products and the cleaning of the transport equipment. This is where I see a lot of untapped potential and I am grateful to those entrepreneurs who have found the courage and who have shown that it is profitable to invest in this equipment and in these countries. At first sight, energy

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saving measures appear to be an easier option as almost any exchange of an old machine with a new one will result in energy savings. There has been some development in the field of utilizing the energy from the combustion residues of the baking ovens, mainly in the Czech Republic, Slovakia and Poland. However, this is still not sufficient as the technical opportunities today are more far-reaching; for example, the economical thermo oil ovens are only present in these markets in small numbers. I have to admit that only a few customers from Eastern Europe ask me how much the energy our mixers consume for a batch of 100 kg dough. This will change in the future as the energy consumption during production will increasingly affect the price calculation for the baked products. I do know about supporting financial programs for energy saving measures, for example in Poland, where some subsidies for bakers were linked to the saving of energy. In most cases, however, the bakers in these countries are neglected by their governments; they hardly get any social attention and their work is neither appreciated nor supported. It is only a few bakers who have received subsidies from the development of the EU's structural fund and I cannot help but get the impression that it will only be people with strong nerves and good contacts who will prevail here. This is more important than the target and purpose of the subsidies.

+ bbi: In which countries do you expect to see the strongest decline in investment activities?

+ Dr. Gerbel: In all countries that have the largest devaluation of their own currency. The order can change from day to day, but I believe that the entrepreneurs in Eastern Europe will make the best of the situation much faster than expected by the West. We have experienced this development several times in the past. I am still fascinated by this phenomenal characteristic of Eastern Europeans.

+ bbi: What do you expect the consequences to be over the next two to five years?

+ Dr. Gerbel: I repeat; I am convinced that the bakers will find their way out of the crisis much faster than other industries and economies. It might last for two years and this must be ridden out. It would be a fatal error to let the crisis take priority.

As already said, I am expecting negative as well as positive effects. The investment activities of the bakers may slow down temporarily, but not forever. The expansion of Western investors into these new markets will be delayed as this business has lost its attraction due to the devaluation of the currencies. With the return of the real value of life and economy as logical results of these "cleaning processes", the social authority of the baking industry will certainly increase. The job market will relax and the many years without good

workers in the baking industry from Riga to the Balkan states will be in the past.

Following the crisis, the market will be much more transparent and the distribution

of positions on the market will probably accelerate. I recommend focusing on this phase, not to panic and to refrain from compromising quality and production efficiency for costs in the future.

+ bbi: How do you assess the current situation of the baking industry in Bulgaria and Romania? How much progress has the transformation process made there already and how much are these countries burdened by the financial crisis?

+ Dr. Gerbel: The development of the baking industry in the youngest EU member states in the past few years has been surprising. The market has been consolidated. It was divided amongst strong domestic companies for which the production of baked goods was more a supplementary activity. There are several Greek, Arabic and Turkish baking companies active on the Romanian and partly also on the Bulgarian market which enrich the domestic industry with their experience. The dynamics in investment has taken us by surprise, particularly in Bulgaria over the last few years. In both countries, the investments were mainly in the production of fine bakery wares and partly in bread. This is only the beginning. In general, the technical equipment in these countries is on a lower level than in Central Europe but the speed of improvement is much faster. One explanation is the fact that the agricultural and food production sectors in both countries have a strong tradition and social position which results in the baking industry being highly attractive for entrepreneurs. This circumstance has not changed with the crisis but is rather vice versa.

At the moment, the investment processes have stopped as a consequence of the devaluation of the currencies and the non functioning banking sector. However, the preparations for the projects continue. This is a good sign for the future.

+ bbi: Dr. Gerbel, thank you for the interview. +++