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The Challenges of a United Europe for the Flavor and Fragrance Industry

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Many months ago, when I selected the title "The Challenges of a United Europe for the Flavor and Fragrance Industry," there was little expectation of the repercussions from the Maastricht Treaty and the collapse of the European monetary system. Perhaps, someone suggested, I should change my talk to the "Challenges of a Disunited Europe," which I have resisted. The pace of unification, however, has at least temporarily slowed down, and the unification with East European countries has slowed down even more.

On September 10, 1992, in one of his campaign speeches, President Bush suggested that the US create a free trade zone with Czechoslovakia, Hungary and Poland. This was rather odd considering, for example, that Czechoslovakia's exports to the US now amount to only 2.5% of its total exports, with over half of its exports and those of Hungary going to Western Europe. Vaclav Klaus, prime minister of the Czech Region, commented it would be "absurd" to create a free trade zone with the US before creating one with Western Europe.

On the other hand, a Hungarian official said the idea could be "an acceptable alternative" if it appeared that Hungary's European integration would take too much time, underscoring the slow pace of Western European/Eastern European integration, and prodding the EC to act faster.

In the meantime, since the split of Czechoslovakia the EC officials have told the Czechs and Slovaks they must conclude a strong customs unit between themselves before they could consider an association agreement with the EC. Previously Czechoslovakia was part of the group with Poland

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EC = European Community
EFFA = European Flavor & Fragrance Association
FEMA = Flavor and Extract Manufacturer's Association
IFF = International Flavors and Fragrances Inc.
IOFI = International Organization of Flavor Industry
R&D = Research & Development

and Hungary; each had signed an interim agreement with the EC contemplating full membership within ten years.

At times, events in Europe do seem to be going backwards or at least sideways rather than forward.

In the meantime, the collapse of the European monetary system reaffirms the age-old truth that politicians cannot keep currency parities stable when underlying economic realities grow more and more divergent. Furthermore, the worldwide currency marketplace is simply too enormous to be controlled by any single government or governments, no matter how rich they may be.

A single day's trading amounts to well over $700 billion US dollars. If the relative value of the currencies does not reflect their real values, neither can the Bundesbank or the US Treasury put their thumb in the dike (as our Dutch friends say) and stop the inevitable flood from coming.

We tend to forget that in Europe there have been several currency systems which have come and gone since the end of World War II. This latest European monetary system, which lasted about ten years, I believe, did provide a stable environment for the European economic community and its trading partners during that period. Its collapse, however, was particularly painful because its existence was de facto the forerunner of the common European currency contemplated by the Maastricht Treaty. If the European monetary system could not survive, it is difficult to see how a common European currency can be achieved. The truth of the matter *is* that without common economic policy and objectives, neither a common monetary system nor a common currency can exist for any prolonged period.

The next question, which of course no one wishes to ask, is: Can the nations of Europe truly achieve a common economic policy without a common government? This was the real issue behind the French vote on Maastricht. Fifty-one percent were emotionally committed to a united Europe but 49% said they did not wish to give up the power to govern themselves to the bureaucracy in Brussels.

Why should officials not elected by us put their long arms into our province and tell us how to make our cheese? But it's not only cheese—it's flavors and fragrances, and many other issues. Draft directives are being written faster than the national associations of IOFI and EFFA can keep up with. The problem is much closer to home than you might think. It is basically a problem of dealing with officials of a government that's not really a government. It is basically the problem of confederation.

It is sometimes forgotten that before the United States of America was founded, we had a Confederation of States for ten years. It might be wise for the politicians of Western Europe, as well as those of the Republics of the former Soviet Union, to study well that period of American history. *Strong independent states do not easily confederate.* Nature abhors a vacuum. In a sense, a confederation creates a vacuum of power. There are usually two ultimate solutions. In the first, the most powerful state or states become the effective dominant government power over the others. In Europe today that is obviously Germany. Such a role requires an outward looking sensitivity and a generous facility for accommodation. I will not presume to comment on the current controversy over whether either trait has been sufficiently displayed during the past several days. The other solution for the power vacuum, as was the case with the United States in 1787, is to form a new central government democratically elected by the people (something that surely few in Europe are ready for).

European unity is still in a dynamic state of evolution. And whether the vote is on Maastricht or some other issue, one truth seems inescapable:

Challenges of a United Europe

The price of unity is the concession of power from the parts to the whole. This has been going on in Europe slowly over the past 40 years. But now it is getting close to the bone. And so, with your indulgence my speech will address "The Challenges of an Evolving Europe, United and Disunited, for the Flavor and Fragrance Industry."

First, may I say that business, particularly international business—and that means our industry—has been far ahead of the politicians and economists. Apart from currency dislocations which we all must adjust to—and God knows we have had enough experience of that, particularly in Latin America—Western Europe has long been a unified economic area. Flavor and fragrance shipments move within 24 hours from Spain to Berlin or from Italy to Britain, as if they were travelling from New York to California. Long before the so-called European integration of 1992, the flavor and fragrance business had looked upon Western Europe as one geographical entity. And, of course, so did our customer companies.

IFF's fine fragrance creative center in Paris is serving all of Europe; our European creative center for soap and household product fragrances is in Hilversum, Holland; our aroma chemical facility in Tilburg, Holland is in the process of being consolidated into our two plants in Haverhill, England and Benicarlo, Spain, and so on.

The concept of having full range companies, doing everything from creating to manufacturing in even the major countries of Europe is passé. You might as well have full range companies in New York, Iowa, Montana, California and Florida, in the United States.

I think we all realize, but it is still difficult at times to convince nationals in a given country, that they are a *part* of a larger European entity and need not be what they call a "complete" company in their own country. The fact is, that issue is no longer relevant. IFF (Europe) is already a reality. What we are working on today is not that but IFF as a *global* company—but that's another story.

In addressing the flavor and fragrance challenge of Europe, I must divide the subject into its separate market segments.

In fine fragrance, we see European growth over the next few years in real terms to be about 2-3% annually at the retail level. This growth rate may increase when economic stability and hard currency become a daily fact of life in Eastern Europe and the republics of the former Soviet Union. These developments will come slowly and painfully, but they will come, for these areas have always had a deep cultural appetite for perfumes and colognes.

The more significant change in Europe is, perhaps, the strong current trend toward consolidation of smaller cosmetic and fragrance houses into the giant international companies—Unilever, Sanofi, L'Oréal, Benckiser-Lancaster Group, Procter and Gamble, and so on.

The pharmaceutical companies are getting out of the business and the soapers are getting in, in a big way and with deep pockets. This in itself can have an effect on the fine fragrance growth rate in Europe, provided that the European recession ebbs and the consumers and travellers are lured back into the market. I say this because there will be big expenditures made by these larger companies both on European launches and to bring American fragrance successes to Europe.

The international giants are out to prove that they made the right acquisitions and they will not be satisfied with the status quo. At the same time, the small independent family-owned fragrance houses will find it increasingly difficult to survive in this environment and more will also probably end up being acquired eventually by the larger entities. Niche fragrance entrepreneurs will always be able to carve out a small piece of the market, but for the flourishing small fragrance houses, the days are becoming shorter. It simply takes too much money to launch a fragrance and continue its support against the onslaught of those players who can spend 10-20-30 million US dollars on a fragrance introduction.

As far as fragrance suppliers are concerned, the same dynamics apply. The larger fragrance companies are consolidating and the smaller houses find survival difficult. I'm afraid this will be increasingly the case as expenditures for R&D become key for new fragrance creations having a competitive edge.

The other significant change is in traditional marketing patterns. The department stores are fighting desperately to maintain their position in fine fragrance marketing, but find their base constantly eroding through new outlets like boutiques, cable television, catalogs, and yes, mass marketing chains which are obtaining fine fragrance franchises never seen there before. This ongoing revolution is bound to have a profound effect on the growth of the fragrance business and the profit margins obtainable.

Today the soap and household product fragrance area is clearly a global one. The large international companies are aggressively pursuing tomorrow's markets—in China, Eastern Europe, the Unified Republics and in Africa, the Mid-East and India. No opportunity is left unexplored. The fight is on, and fragrance is more important than ever, particularly in consumer acceptance, enlarging market share and introducing new product concepts and variants.

As far as Europe is concerned, the trend to *centralization and product simplification* in the soap and household product area seems to be the driving force. This is also consistent with what I have mentioned previously, that Europe is increasingly looked upon as a single market for those product lines where that makes sense. This in turn requires fragrance companies to reorganize *themselves* to deal more centrally. This does not entail ignoring local or national market needs or idiosyncrasies; rather it means integrating these into a unified effort which mirrors that of the customer company.

In contrast to the fine fragrance, the soap and household product fragrance market in Europe will grow at a faster rate, closer to 4-5% annually over the next few years.

Lastly, the aroma chemical market will continue to expand with increasing pressure on costs and profit margins, much the same situation as with naturals and essential oils. Patented specialties will be increasingly important, not only for product innovation and competitiveness but also as a way for the producers to maintain reasonable profit margins. Investment in commodity chemical production will be especially risky with oversupply a likelihood in many instances. It will not be a game for amateurs.

As far as IFF is concerned, we will continue as we have in the past, to make our patented speciality aroma chemicals available to our competitors. We continue to believe that fair competition is healthy not only for the industry but also for ourselves, to maintain the pressure necessary to pursue and produce excellence.

The flavor market in Europe for the next decade will be an entirely different challenge. While not easy, the opportunities will be more diverse than ever, far more so than in the fragrance field. The trend to health foods, already well begun here, will spread. Removal of the culprits—fat, calories, sugar, salt, cholesterol, all taste good—must be compensated for with flavor replacements. We call them flavor systems since they do not provide merely the flavor, but a number of other aspects required of the taste experience—mouth-feel, moisture content, browning effect, and so forth. Prepared foods for vegetarians and others require savory flavors (such as meat, cheese, chicken) to make them more palatable. Low-fat yogurt and low-fat cheese, non-alcoholic wines and beers, flavored teas, flavors for sugar-less desserts, dairy products and cereals are some other areas with new flavor demand.

The joint venture between General Mills and Nestlés is designed to take advantage of the expanding European dry cereal market. Snack foods, a growing market segment, will experience significant growth.

Similarly, foods for physically active people are becoming part of the European scene. These foods include breakfast bars and beverages such as Gatorade and Lucozade (the British beverage entry at the Olympics)—all of which are designed to replace electrolytes, potassium and other nutrients after exercise.

At the other end of the spectrum, high fat ice creams such as Hagen Daz are gaining in popularity in Europe. Again a top quality flavor is required.

Fish flavors for surimi, convenience foods made from processed whole fish, include lobster and crab flavors.

The popularity of ethnic foods for example, Italian, Chinese, Japanese, Mexican and Indian, is another expanding European phenomenon, particularly with the younger generation.

Flavored mineral waters and 'New Age' beverages which contain fruit juices and high impact flavors are now reaching Europe also.

The list is endless, and those who believe Europeans will not succumb to adventuresome taste experiences may be making a critical marketing mistake.

Of course the appetites in Eastern Europe and the former Soviet Union for these new foods are already being indulged, to the extent that people have the where-with-all to buy them. I suppose experimentation with new taste sensations come more readily if the available food supply is less appealing.

Much of this growing European flavor market again requires technological expertise and continuing R&D investment. It is part and parcel of the changing flavor industry moving from the traditional to the more complex and scientifically advanced processes and products. There will always be a traditional flavor business, but the larger opportunities will be met by those companies able to meet the challenge of the next generation of flavor systems required by the changing patterns of food and beverage consumption.

One word of warning—all of these new developments can be endangered by the enactment of ill-advised legislation governing flavors within the EC. The flavor industry has not only been remarkably safe, but also a pioneer in assuring the safety of its own products, through well-conceived safety evaluation procedures, exercised through independent qualified experts as in the FEMA expert panel.

It has taken decades to assemble this valuable body of safety data, accepted by the US Food and Drug Administration as proof of safety of the ingredients we use. Through our organizations in Europe we must ensure that the importance of this work is understood by the authorities and used as a basis for future ongoing flavor ingredient safety review.

And so we exist in a Europe in transition. We see nations reverting to the old territorial disputes and tribal enmities, in the Balkans, Czechoslovakia and the republics of the old Soviet Union. We are in the trough of a recession. All this can blind our longer vision but we, and especially the younger among us, must see the present in its proper perspective. No one expected the collapse of an empire the size of the Soviet Union without agony and bloodshed far greater than now being experienced. For the first time in this century, we have the clearest opportunity we ever had to build a new and peaceful world. It will take time. No one ever expected that Europe would soon rebuild from the devastation of World War II. Now we argue about currency rates, jockeying for national position with little recollection of those days. These problems too shall pass and we will be part of the building.

I can't think of a business better suited to survive and grow in the future environment of Greater Europe than that dedicated to the two senses of taste and smell. And on a global basis, the flavor and fragrance industry stands on the threshold of opportunity and success far greater than it has experienced ever before.

Reference

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