

Tractors aren't cars!

5 questions to Gilles Dryancour on the major structural trends impacting farm machinery business of today

CEMA: What is so different about the business of selling tractors and farm machines in comparison to, let's say, selling automobiles?

GD: It's a world of a difference we're talking about! The most fundamental differences probably are: the customers, the size of the industry, and the complexity of the vehicles.

When we talk about the customers and their needs, with the exception maybe of taxi-drivers, most car owners aren't professional investors, and their economic security is not threatened by the breakdown of their vehicle. By contrast, customers of tractors and farm machines are nearly all professional investors, be they farmers or contractors. The farm machine is their vital production tool. If it breaks down, for instance, during harvesting season, their annual income might be lost. As such, our customers are far more dependent on the reliability of our equipment than the average car-driver.

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So, the farmer's essential demands are: *the machine should never break*. In case it does, *my dealer has to fix-it immediately*. Our dealers thus have to be available 24/7 and we, as the manufacturers, must be able to ship spare parts to any given EU farm as quickly as possible.

By contrast, car owners do not expect their dealers to fix their car immediately. They can use a replacement car or their second vehicle. In most of the cases, it is also possible for car-drivers to take public-transportation to go wherever they want to go.

The second major difference is the size of the two industries. In the EU, a new car is sold every two seconds. This means that the automotive industry sells about as many cars in three and a half days in Europe, as our industry sells tractors in a full calendar year! Consequently, our logistics and distribution costs are far higher than those for the car industry. We cannot amortize these costs on a large scale. This is clearly reflected in the inventory turnover. The inventory turnover for agricultural equipment dealership, in Europe, is about 2.5. It is somewhere between 5 and 6 for the automotive dealership. Practically, this means that an agricultural machinery dealership is at least two times more expensive to operate than a car dealership.

Finally, tractors aren't comparable to cars, as they have a much higher complexity: a mid-spec tractor has 6,000 up to 9,000 different parts versus 4,000 parts on a typical passenger car.

They also contain much more advanced technologies than a car. As a result, we have to invest much more in human skills than the automotive industry. Both our

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dealers and our customers need to be trained, while only very few automotive brands, like, for instance, Ferrari or Lamborghini, offer special driving lessons for their clients to run their automobiles.



CEMA: Your study underlines that the number of farmers in Europe has fallen sharply, eroding the industry's customer base. Will this trend continue? If so, what impact will it have on manufacturers?

GD: In my view, it's a long-term structural trend which, all things being equal, could hardly be reversed. The trend started in the 19th century with the industrialization of Europe and the rural exodus. From that time onwards, cities offered better jobs, income opportunities, infrastructure, education, medical and leisure facilities... That's how some European countries reached an unprecedented level of urbanization. In 2014, the urban population represented 79% of the total population in France, 82% in Germany and 98% in Belgium. It's also a global trend. In 2015, the urban population reached 81.7% of the total in the U.S. In China it moved from 50%, in 2010, to 54% in 2014. It is expected to reach 60% in 2018.

In Europe, this trend will accelerate because of the ageing rural population. According to Eurostat, 31% of EU farmers are older than 65 years, whilst 6% are less than 35. Today, we cannot predict what portion of the generation above 35 years old (94% of the farmers' population) will be replaced. But it is safe to assume that a large fraction of these farmers will not be replaced. Noticeably, in Eastern Europe. So, in our view the farmers' population in Europe will steadily decrease in the next decades. The only scenario that could reverse this trend would be a major collapse of the economy like in Greece, where some of the urban population moved to the farmland to ensure its survival. But even in this tragic case, it remained a marginal phenomenon.

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Regarding the impact of this long-term demographic trend, we need to dissociate between highly and poorly urbanized countries.

In countries like France and Germany, the rural population will likely slowly and steadily decrease. The market for mid-spec equipment will most probably decline. Farmers will ask for more advanced technologies and more performing equipment. The volumes of the equipment will certainly be lower but they might have a higher value. Depending on which trend of the two will take over, the total market-value potential will shrink or not.

In countries like Poland, Hungary, Bulgaria and Romania, the rural population is likely to decrease faster than in Western Europe. More farm consolidation will then occur. The market

segment for mid-spec and high-hand equipment could potentially grow. Still, one needs to be careful here. The trend underlined above exists for a long time in Eastern Europe but didn't lead to a new Eldorado for our industry.

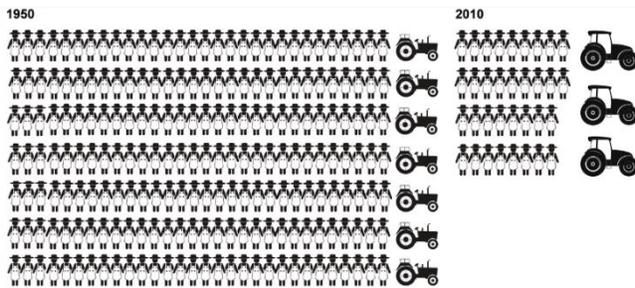
CEMA: One chapter of your study focuses specifically on the concept of 'customer density'. What exactly does that concept entail and in how far does it directly impact the farm machinery's market structure?

GD: I started to develop this concept to underline the difference between the passenger cars' market structure and the tractor's market. Both markets are often perceived as identical by the EU regulator. Some compelling figures could help, here, to understand what the differences are all about. The total area of the EU is 4.4 million km². The car industry sells about 16

million units in the EU per year. We sell about 170,000 tractors per year.

So if we only consider the number of units sold by both industries per km², we get a ratio of 3.7 units for the car industry and 0.03 for the farm machinery industry. Of course, these are very theoretical figures, since they include forests, mountains, lakes, seashores and so forth. However, these two ratios already tell us that the two market structures could not be the same. Immediately, some questions come to our mind. For instance: how do we build our dealership when we have such a vast area to cover and so few units to sell? How do we organize our logistic and at what cost? How do we amortize our commercial investments? How do we reach out to farmers?

Now, if we add to these facts the density of customers, we can see an even bigger contrast between the two market structures. At this point, I would quote the figures I shared in the study: *7 new tractors were sold in 1950 in an area of 100 km² inhabited by 210 farmers. In 2010, these figures dropped to 3 new tractors being sold per 100 km² which were inhabited by merely 34 farmers.* At the same time, the car



industry saw its customers concentrating in urban areas and their numbers increasing continuously. In some European capitals, Paris for instance, the density could easily reach up to 20,000 people per km². Now, some academics compare our market with the passenger cars' market and claim that our industry has led an adverse strategy which resulted in the concentration of our dealership, forcing our customers to pay unduly high prices for the services they require. Correlatively those

academics propose to increase the number of agricultural equipment dealers, by the same coercive regulatory measures which have been put into place for the passenger car industry. As we understand, this kind of reasoning demonstrates the total ignorance of the realities of our market. How can anybody imagine that we could increase the number of dealers when the customer density goes down year after year? This is non-sense. In fact, international studies tend to show that the average number of dealers, for the same given area, is higher in Europe than in other Western countries, i.e. the United States, Australia or New-Zealand.

CEMA: How has EU regulation of tractors and farm machinery changed in recent years?

GD: Since 1974, the European Commission's administrative Unit responsible for developing technical regulations for tractors has been the one that is also in charge of the automotive sector. This connection sprang from a purely internal logic of the European Commission, based on the presumed structural proximity between both industries. Nonetheless, between 1974 and 2003, this administrative arrangement did not exert adverse effects upon the agricultural machinery industry. In fact, by creating for the first time an internal market for tractors, the harmonized single type-approval scheme established by Directive 74/150/EEC conveyed considerable benefits to the industry and its customers.

Despite the fact that, since 1974, European regulation resulted in a gradual, steady increase in compliance and thus production costs, the agricultural machinery industry was able to offset these additional costs thanks to the benefits created by the gradual unification of the European tractor market.

Throughout this period, tractors were recognized for what they are: capital goods for agricultural work. And EU work focused primarily on technical harmonization. That was

the rationale behind the EU's Working Group on Agricultural Tractors (WGAT). In addition, the possibility of type-approving tractors nationally was maintained, which was a safeguard mechanism to keep legislation focused on the specificities of tractors.

In 2005, a sudden paradigm shift in the EU's regulatory approach towards the agricultural machinery industry occurred: a switch to treat tractors as automobiles. Thus the idea was born that EU automobile regulations should, by and large, also apply to tractors – notwithstanding the fact that the use of the machines and the economies of scale in both industries are entirely different. The consequences of this new approach were unexpected and severe. As a result, production costs have exploded in recent years.

In light of strong concerns from the industry, the European Commission proposed a “simplification” and offered to revise the brand-new framework Directive for tractors (2003/37/EC), claiming that industry would be the prime beneficiaries of such a reform. However, it quickly became apparent that not only would all the obligations of Directive 2003/37/EC be retained in the new framework Regulation (now Regulation 167/2013/EC), but new constraints would be added above and beyond this.

As a result, the regulatory costs have exceeded the benefits (the % regulatory costs increase exceeded the productivity gains) and the European market for tractors has shrunk dramatically.

CEMA: Looking ahead, how could future EU regulation better take into account the structural realities and changes in the industry which you have identified in your study?

GD: We need a veritable U-turn in EU regulation and industrial policy. More specifically, we need EU regulation for farm machines:

- to recognize and understand the structural specificities & drivers of the sector;
- to abandon the distorted and harmful logic of using an automotive-based regulatory approach for tractors and farm machines;
- to adopt a forward-looking regulatory approach that allows the European farm machinery industry to define its own technical standards and move towards more self-certification.

We also need a shift in terms of EU policies so that they:

- Support the advent of farming 4.0, by allocating the appropriate budgetary means to the EU R&D programs.
- Develop the needed communication infrastructures (5G).
- Ease the transition to a sustainable and profitable agriculture (CEMA proposes to establish a sustainability bonus as an alternative to the greening measures of the CAP).
- Encourage the up-take of precision farming technologies by all farmers.

Perhaps recent political events can help to raise the level of awareness of the profound challenges the industry has to face in Europe. The agronomic, environmental and societal case for more innovative advanced farm machines is clearly there: farmers will need them to work their land in more productive, sustainable and profitable ways and feed a growing world population. EU regulation should do its best to support this transformative journey in farming and farm machinery in the years ahead and turn it into a success story for Europe. The industry stands ready to help in the process.

