

The Food Marketing System in 1995. By Anthony E. Gallo. U.S. Department of Agriculture, Economic Research Service, Food and Consumer Economics Division. Agriculture Information Bulletin No. 731.

Abstract

The number of new food processing plants rose sharply in 1995. Profitability from food manufacturing and retailing operations (excluding interest expense) continued to increase, reflecting strong sales, wage and producer price stability, and streamlining of operations. The number of mergers and leveraged buyouts fell. New product introductions, consumer advertising expenditures, common stock prices and the positive U.S. balance of trade in processed food reached new highs.

This report analyzes and assesses yearly developments in growth, conduct, performance, and structure of the institutions—food processors, wholesalers, retailers, and foodservice firms—that comprise the Nation’s food marketing system. Industry growth includes changes in sales for each of the four sectors, product mix, and external economic factors affecting the food system. Conduct measures firms’ competitive behavior, which includes such price and nonprice competition as advertising, promotion, new product introduction, new store formats, price discounting, and menu variety. Performance includes profitability, capital expansion, foreign trade and investment, research and development, capacity use, equity market changes, and productivity. Structure developments include mergers, acquisitions, divestitures and leveraged buyouts, and changes in the number of companies and establishments.

Keywords: food marketing, food processors, wholesalers, retailers, foodservice, advertising, profitability, trade.

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INDUSTRY GROWTH

Sales Higher

Food marketing sales reached \$862 billion in 1995. The food marketing system's share of income fell from 11.2 to 11 percent.

General Economy. The U.S. economy slowed in 1995 as gross domestic product grew by an estimated 2.1 percent, down from 1994's 3.5 percent. Industrial production (mining, manufacturing, and utility) output increased 5.0 percent. Business equipment spending grew 7.5 percent, down from 1994's 10.0 percent. Employment was up over a million jobs in the last half of 1995 compared with the end of 1994, but over 100,000 manufacturing jobs were lost.

Consumer spending for 1995 grew about 2.4 percent, down from 1994's 3 percent. Relatively low interest rates, widely available credit, mortgage refinancing, and good growth in employment kept consumer spending strong.

Sales. The increase in consumer spending was reflected in the food system's sales growth. In 1995, the food system's retail sales, adjusted for price and population increases, showed a 1-percent increase.

The share of disposable income fell to 11.0 percent (fig. 1). Food at home accounted for 6.7 percent, while food away from home accounted for 4.3 percent.

Total sales of items purchased at foodstores and foodservice establishments, packaged alcoholic beverages and drinks purchased at eating and drinking places, and nonfood items purchased in retail foodstores reached an estimated \$862 billion, 3.8 percent above 1994 (fig. 2).

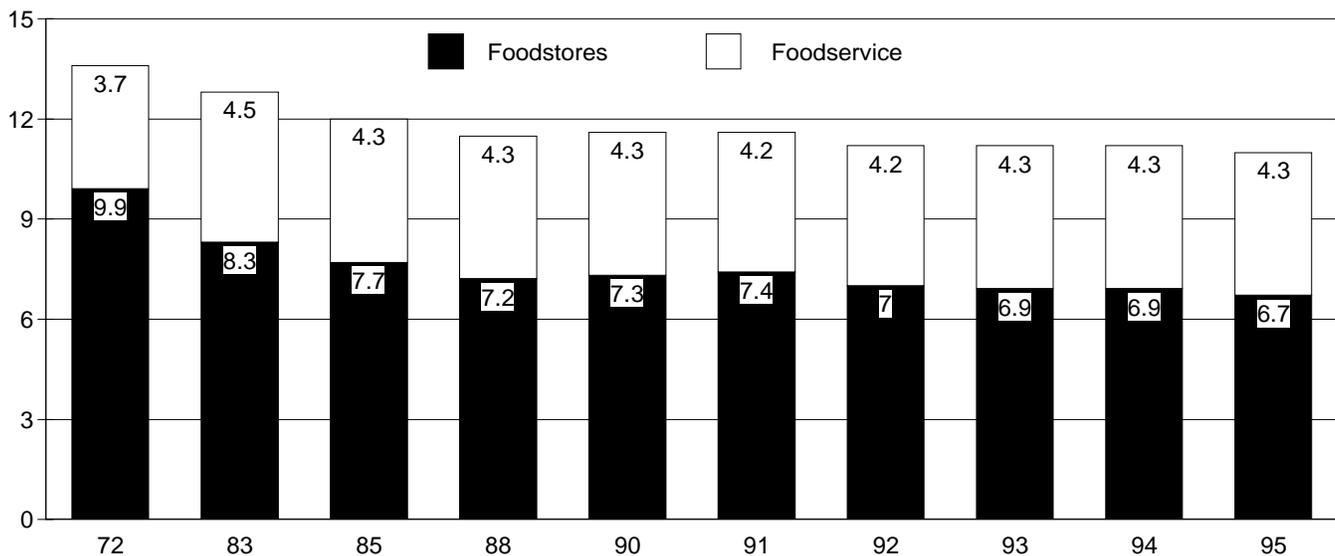
Product Mix. About \$360 billion was spent in retail foodstores and \$309 billion in foodservice establishments in 1995. The 3.4-percent increase in retail foodstore sales was slightly above the increase in retail prices (3.3 percent). The 4.7-percent increase in foodservice sales was offset by a 2.3-percent increase in restaurant prices, implying a 2.4-percent real gain.

Figure 1

Food marketing system's share of disposable personal income

The food marketing system's share of income fell to 11.0 percent in 1995.

Percent



Source: ERS/USDA.

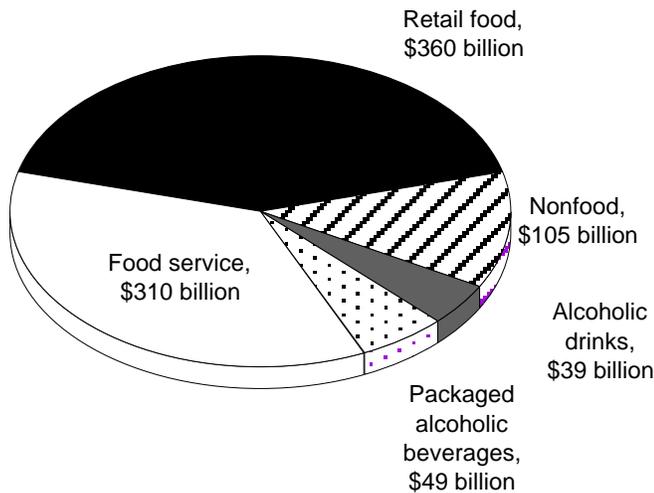
The alcoholic beverage market, which accounted for about 12 percent of sales in the food marketing system, continued to reflect lower consumption. Alcoholic beverage sales accounted for \$88 billion in 1995. Over \$49 billion was in the form of packaged alcoholic beverages, while alcoholic drinks served in restaurants and other institutions likely amounted to nearly \$39 billion. Distilled spirits in 1995 likely accounted for about 31 percent of total alcoholic beverage consumption, while beer accounted for nearly 58 percent. Wine sales appear to have fallen to about 12 percent of the total.

The nonfood component of retail sales amounted to about \$105 billion. Nonfood groceries include tobacco, health and beauty aids, detergents, paper products, and gasoline sold in convenience stores, and other grocery items sold through retail foodstores. Nonfood items, such as tobacco products, catering supplies, and nonfood supplies sold through vending services, are grouped in the foodservice category.

Figure 2

Food marketing sales, 1995

Food marketing sales rose to \$862 billion in 1995.



Source: ERS/USDA.

Measures of Growth

The following indicators are used in this and the following section to measure growth in the food marketing system.

- Sales
- Product mix
- Share of income
- External economic factors
 - » Farm prices
 - » Wages and other labor costs
 - » Advertising costs
 - » Interest rates
 - » Value of U.S. dollar
 - » Adding value to raw farm products

Economic Climate Favorable to Costs

Wages, producer prices, interest rates, and the value of the U.S. dollar were favorable to the food marketing system in 1995. The food system purchased an estimated \$114 billion in U.S. agricultural commodities, \$24 billion in foreign agricultural commodities, and \$10 billion in seafood products. The system then added an estimated \$627 billion in value to these raw products.

The economic climate was favorable to the food marketing system for the 13th consecutive year in terms of costs. The food system is labor-intensive and sensitive to farm prices. The system is also highly leveraged and global, as well as advertising-intensive. Consequently, movements in wages and prices, interest rates, and the value of the U.S. dollar affect the performance of the food sector and all were favorable to the food system in 1995.

Prices. Price stability for purchased food and feed inputs for each channel in the food marketing system is reflected by the Producer Price Index (PPI). The PPI for finished consumer foods, an indicator of changes in prices paid by retailers, wholesalers, and restaurateurs to food manufacturers, rose 1.7 percent in 1995 compared with 0.9 percent in 1994 (fig. 3). However, the PPI for intermediate foods and feeds, an indicator of changes in prices food processors pay one another, increased 0.8 percent in 1995 compared with 2.5 percent in 1994. The PPI for crude foodstuffs, or prices paid by food manufacturers, declined 0.6 percent after a 1.8-percent decrease in 1994.

Labor Costs. For the 13th consecutive year, labor costs, which include hourly earnings and fringe benefits, constituted the major expense item for the food marketing system. In 1995, the food marketing system had about 13.8 million full- and part-time employees. Over 7.7 million workers were employed in food service and more than 3.5 million were employed in food retailing. About 1.7 million were employed in food processing, and over 894,000 worked in grocery wholesaling. Average hourly earnings in food retailing and food processing increased 2.6 percent. In food retailing, wage concessions, benefit reductions, and lump-sum payments were sometimes negotiated in lieu of wage hikes, continuing a decade-old trend. Wages in eating and drinking places averaged 2.2 percent higher, at \$5.59 per hour.

Advertising. The food system, the economy's largest advertiser, faced increased advertising costs for

evening network television, network radio, magazines, and newspapers. Increases ranged from about 9.6 percent for night-time network television to 7 percent for magazines. The cost of spot television ads rose 5 percent.

Interest. Interest rates were mixed in 1995. The prime interest rate averaged 8.83 percent compared with 7.15 percent in 1994. Short-term rates also rose, as reflected in an increase in 3-month Treasury bills from 4.29 percent in 1994 to 5.51 percent in 1995. Long-term corporate bond rates, however, averaged about 7.59 percent, compared with 7.97 percent in 1994.

Value of the U.S. Dollar. The value of the U.S. dollar fell sharply in 1995. The trade-weighted value index of the U.S. dollar fell from 91.3 to 84.2 between 1994 and 1995. This decline boosted remittances of overseas profits of American food companies. The lower valued U.S. dollar also made U.S. exports of processed foods more attractive to foreign buyers and imports less attractive to U.S. buyers.

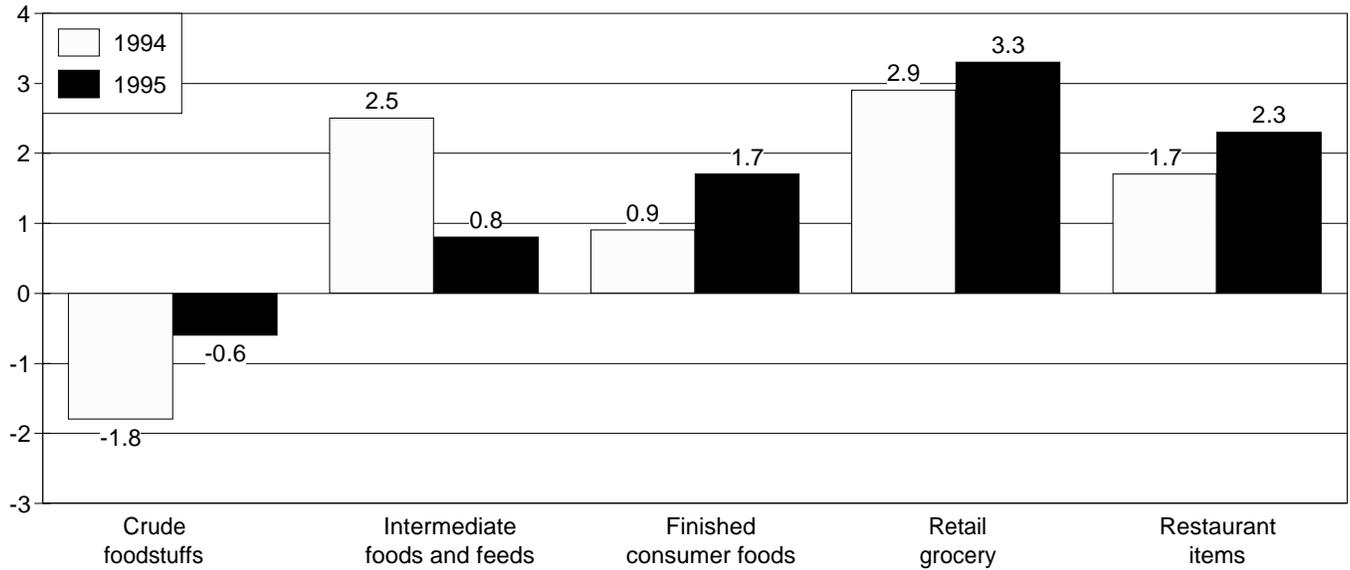
Value Added. The food system purchased about \$114 billion in animal and crop products from the U.S. farm sector, about two-thirds of domestic production. An additional \$24 billion was spent on imported agricultural products, and \$10 billion was spent on seafood. To this base of \$147 billion in raw agricultural and fishery products, the food system added an estimated \$627 billion in value in 1995 compared with \$605 billion in 1994 (fig. 4). Food processors added about \$125 billion in 1995, while wholesalers, retailers, and transportation firms added another \$141 billion. The contribution of separate eating and drinking places to value-added topped \$123 billion in 1995.

Figure 3

Producer and retail price index changes for food marketing system, 1994-95

The PPI reflected higher input prices paid by most channels of the food marketing system in 1995.

Percent change

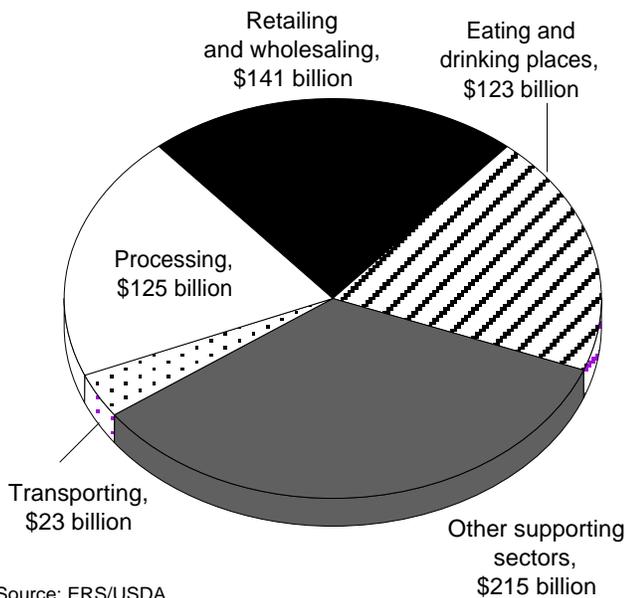


Source: ERS/USDA.

Figure 4

Estimated value added in food marketing system, 1995

The U.S. food marketing system added about \$627 billion in value to raw products in 1995.



Source: ERS/USDA.

STRUCTURE

Merger Activity Slowed in 1995

The number of mergers and value of those transactions both fell in 1995. The number of new food companies and plants appears to be on the rise.

In 1995, merger and leveraged buyout transactions in the food marketing system fell. The number of acquisitions (purchase of company or subsidiary) fell from 432 in 1994 to 425 in 1995 (fig. 5). The number of food processing mergers rose by 8 and foodservice by 5. There were 18 fewer food retailing mergers in 1995, the largest change from 1994 among food marketing sectors (table 1).

The value of food marketing mergers and leveraged buyouts (of more than \$100 million) fell from a \$11 billion in 1994 to \$8 billion in 1995 (fig 6).

Leveraged buyout activity was minimal.

Food processing ranked 14th among all manufacturing industries in the value of mergers. Food wholesalers ranked sixth among all wholesalers, while food retailers ranked second.

Between 1982 and 1995, nearly 7,000 mergers, divestitures, and leveraged buyouts took place in the

Measures of Structural Development

The following indicators are used to measure structural development in the food marketing system.

- Mergers—The combination of two or more firms into one.
- Acquisitions—The purchase of a business unit or subsidiary.
- Divestitures—Selling of a business unit or subsidiary.
- Leveraged buyouts—The purchase of the common stock of a company through debt financing, pledging assets of the new company as collateral.

Table 1—Food marketing mergers

Year	Processing	Wholesaling	Retailing	Food service	Total ¹
			<i>Number</i>		
1982	250	38	38	51	377
1983	225	38	45	64	372
1984	242	37	60	78	417
1985	291	64	52	73	480
1986	347	65	91	81	584
1987	301	71	65	77	514
1988	351	71	76	75	573
1989	277	65	53	72	467
1990	208	58	37	47	350
1991	181	35	39	36	291
1992	217	59	29	59	364
1993	266	57	39	71	433
1994	232	62	60	78	432
1995	244	56	42	83	425

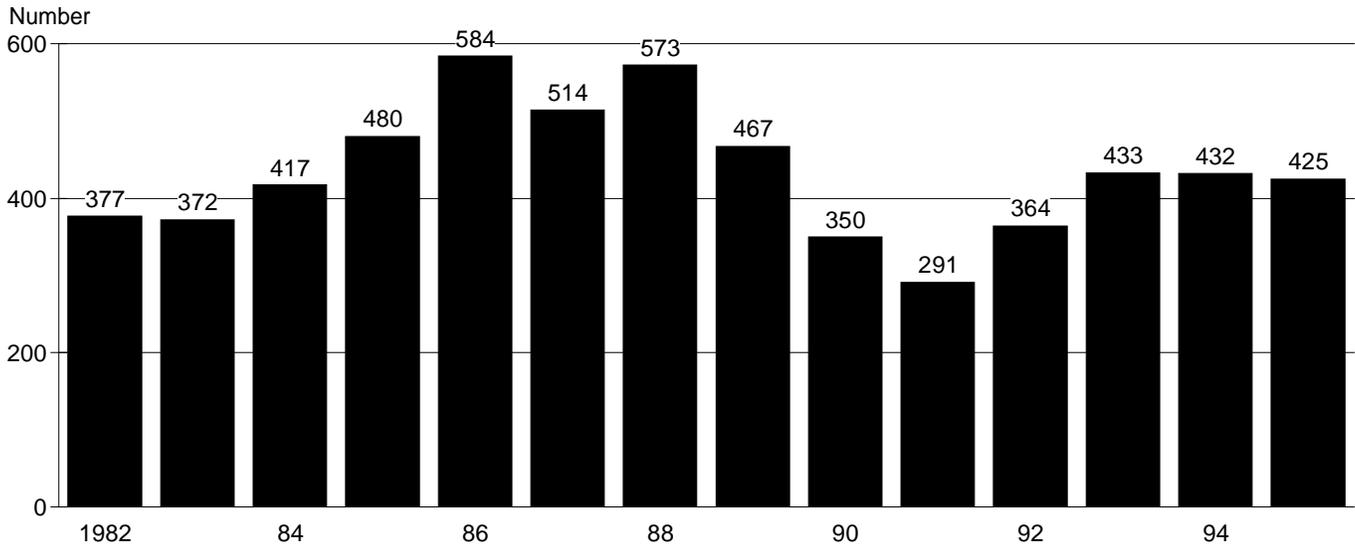
¹ Total includes some double-counting because of interindustry mergers. For example, a food processing firm merging with a foodservice firm is included as an acquisition in each sector.

Source: ERS tabulations of Food Institute data.

food marketing system. Included among these were some of the largest transactions in U.S. history. Despite the merger activity and consolidation, the number of food processing plants appears to be increasing. According to the 1992 Census of

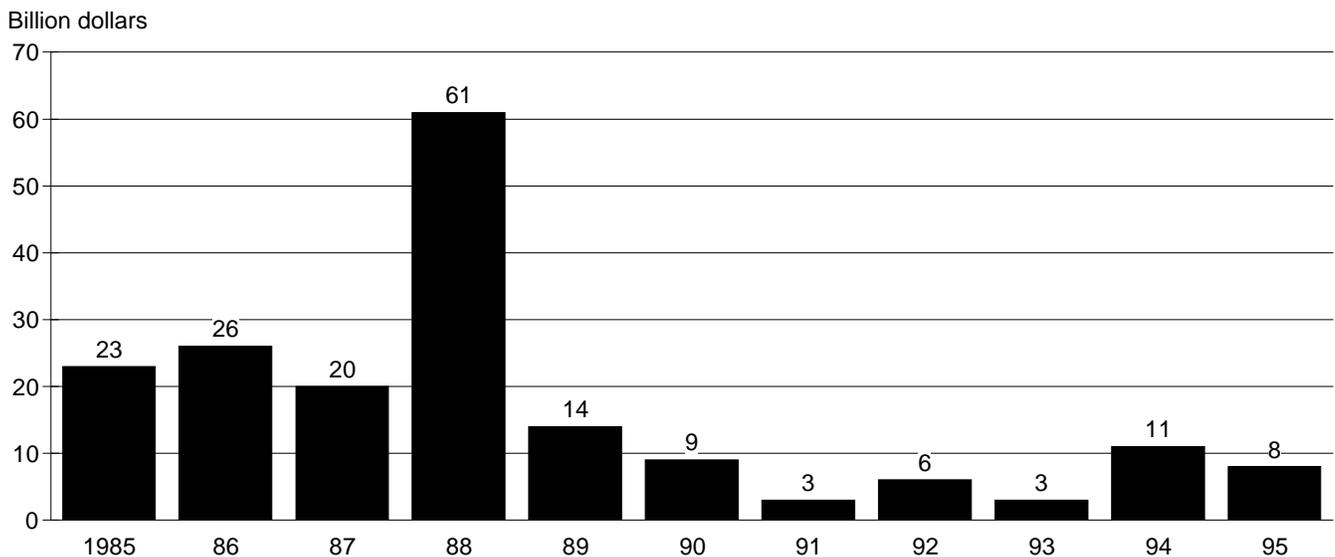
Manufacturers, the number of food processing companies rose from 15,692 in 1987 to 16,075 in 1992. The number of plants also increased from 20,583 to 20,792. Interim trade intelligence since 1992 indicates that the trend is continuing.

Figure 5
Food marketing mergers and acquisitions
The number of mergers fell in 1995.



Source: ERS/USDA.

Figure 6
Value of food marketing mergers and leveraged buyouts costing more than \$100 million
The value of mergers also fell in 1995.



Source: ERS/USDA.

C O N D U C T

Price and Nonprice Competition Vigorous

Food prices rose 2.8 percent in 1995. Advertising increased, and nearly 23,000 new products were introduced.

The food industries' slow growth in 1995 affected conduct, or how firms compete. In 1995, less than 9.3 percent of the Nation's GDP was generated by the food marketing system, compared with 12 percent in 1972. And, while the value added by the food system has increased in dollar terms, a much greater portion of this output was supplied by fewer and larger firms. Although food marketing has become significantly more concentrated, firms in each market sector sought to acquire or maintain market shares through both price and nonprice competition. In 1995, there was vigorous competition among manufacturers, wholesalers, retailers, and foodservice firms for both the consumer dollar and among manufacturers for scarce shelf space in the Nation's grocery stores.

Consumer prices for food increased 2.8 percent in 1995 compared with 2.4 percent in 1994. In 1995, food prices in grocery stores rose 3.3 percent, while foodservice prices were up 1.7 percent (fig. 3). The food marketing system charged moderately higher prices for red meats, sugar products, and dairy, but higher coffee and fresh fruit and vegetable prices contributed significantly to the all-food increase in 1995's Consumer Price Index.

Price competition to gain market shares was apparent in the fast-food sector, where major discounts were given to consumers. These discounts apparently reflect both seller saturation and the slowing economy. Consumer discounts were also evident in the Nation's grocery stores, where discounts were given on such products as tuna, pasta, soft drinks, and breakfast cereals, all in highly concentrated industries.

Nonprice competition to differentiate the product in the eyes of the consumer continued strong by the two

routes in which the food system has always been the forerunner: new product introduction and advertising.

The Nation's food processors introduced over 22,500 new grocery products in 1995, an increase of nearly 12.5 percent over 1994 (fig. 7). New food products (16,900) rose 12.5 percent above introductions in 1994, while nonfood groceries rose to about 5,700 new products. Candy, condiments, breakfast cereals, beverages, bakery products, and dairy products accounted for 75 percent of new product introductions. Nearly 2,000 new food product introductions bore reduced- or low-fat claims. New grocery products introduced between 1982 and 1995 totaled over 156,000. However, many of these new products were withdrawn from the market after a relatively brief time.

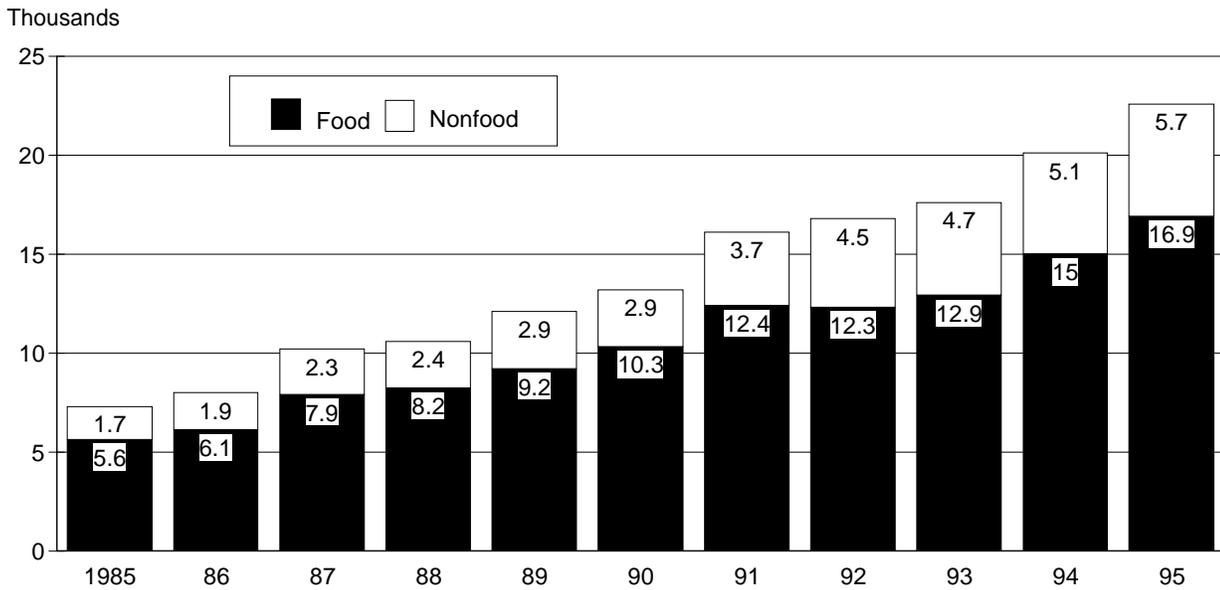
Food marketing firms spent an estimated \$10.2 billion in direct consumer advertising—such as electronic and printed media and coupons—in 1995, compared with \$9.8 billion in 1994 (fig. 8). Food processors spent over \$6.7 billion on mass media advertising, while food retailers spent over \$800 million (excluding local newspapers). Restaurants, mostly fast-food chains, spent almost \$2.4 billion. In addition, the food marketing system spent billions of dollars on coupons, games, incentive advertising, and other direct consumer promotions.

Competition was also keen in getting products on the shelves of the Nation's grocery stores. By most industry estimates, food processors spent about \$2 on retail promotion—trade shows, promotions, discounts and allowances, and other incentives—for every \$1 in direct consumer advertising.

Figure 7

New food and grocery product introductions, 1985-95

Nearly 17,000 new food products were introduced in 1995; most were extensions of already existing products.

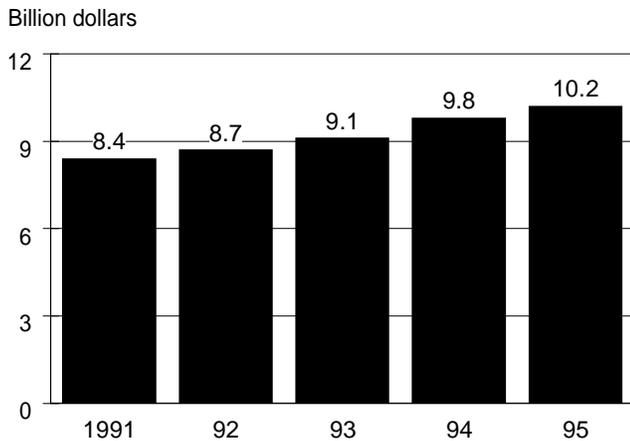


Source: ERS/USDA.

Figure 8

Food-related advertising (excluding coupons)

Food marketing firms spent over \$10 billion on direct consumer advertising in 1995.



Source: ERS/USDA.

P E R F O R M A N C E

Debt Levels and Profits from Operations Both Higher

Debt of the Nation's food processors and retailers rose \$16 billion in 1995. Profits from operations were higher.

Debt. Total liabilities of food processors and retailers rose \$16 billion in 1995 to \$318 billion (fig. 9). The food industry remained one of the most leveraged in the American economy. The equity-to-debt ratio of food manufacturers rose from 0.92 in 1994 to 0.96 in 1995, but was still well below the ratio for all manufacturing (1.46). The equity-to-debt ratio for food retailers rose from 0.53 to 0.66 between 1994 and 1995 (fig. 10). By comparison, the ratio for all retailers was 1.00.

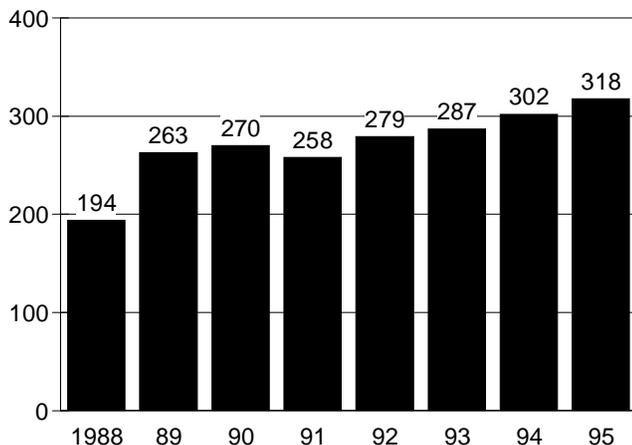
Profits. Food processors and retailers showed an increase in profits from operations. Food and tobacco processors' profits from operations rose from \$37 billion in 1994 to \$38 billion in 1995 (fig. 11). Food retailers' operational profits rose from \$7.2 billion, an 8.3-percent increase. These increases reflect modest increases in labor and ingredient costs. Many food marketing corporations also reduced staffs and other operational costs. The lower value of the U.S. dollar further boosted income from foreign operations.

Figure 9

Total liabilities of food and tobacco processors and retailers

Debt levels increased again in 1995.

Billion dollars



Source: ERS/USDA.

After-tax profits as a portion of stockholders' equity for food processors rose to 18.5 percent (fig. 12). Retailers' after-tax profits amounted to 0.5 percent of sales and 17.2 percent of stockholders' equity. However, after-tax profits among both processors and retailers varied significantly. A true picture of profits is difficult because much of food sales are controlled by large, diversified food marketing firms.

Measures of Performance

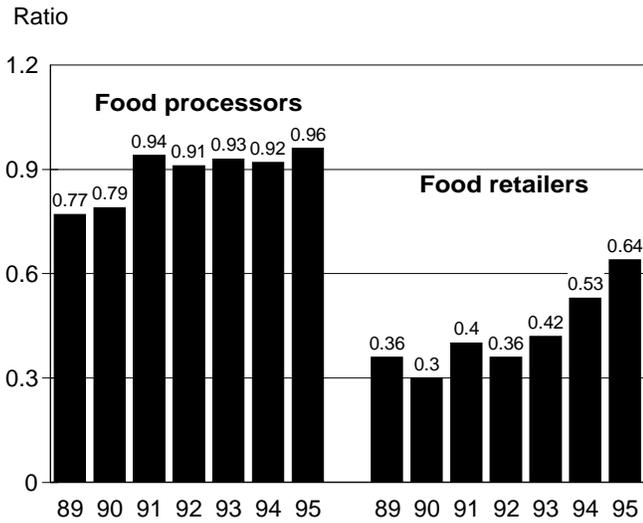
The following indicators are used in this and the following four sections to measure performance in the food marketing system.

- Debt
 - » Stockholders' equity-to-debt ratio
- Profits
 - » After-tax profits to sales
 - » Return on stockholders' equity
- Expansion, modernization, and production capacity use
 - » Capital expenditures
 - » Research and development
- Productivity
 - » Output per hour
- Investment performance
 - » Common stock prices
 - » Stockholders' equity appreciation
- Participation in the global market
 - » Foreign trade balance
 - » Foreign investment

Figure 10

Food system's equity-to-debt ratio

The ratio of equity to debt rose for both processors and retailers in 1995.

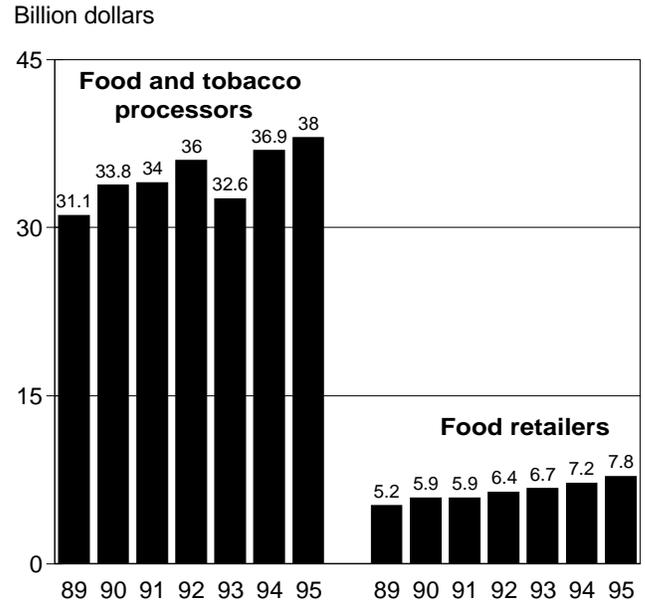


Source: ERS/USDA.

Figure 11

Profits from domestic operations, food processors and retailers

Profits rose for both processors and retailers.

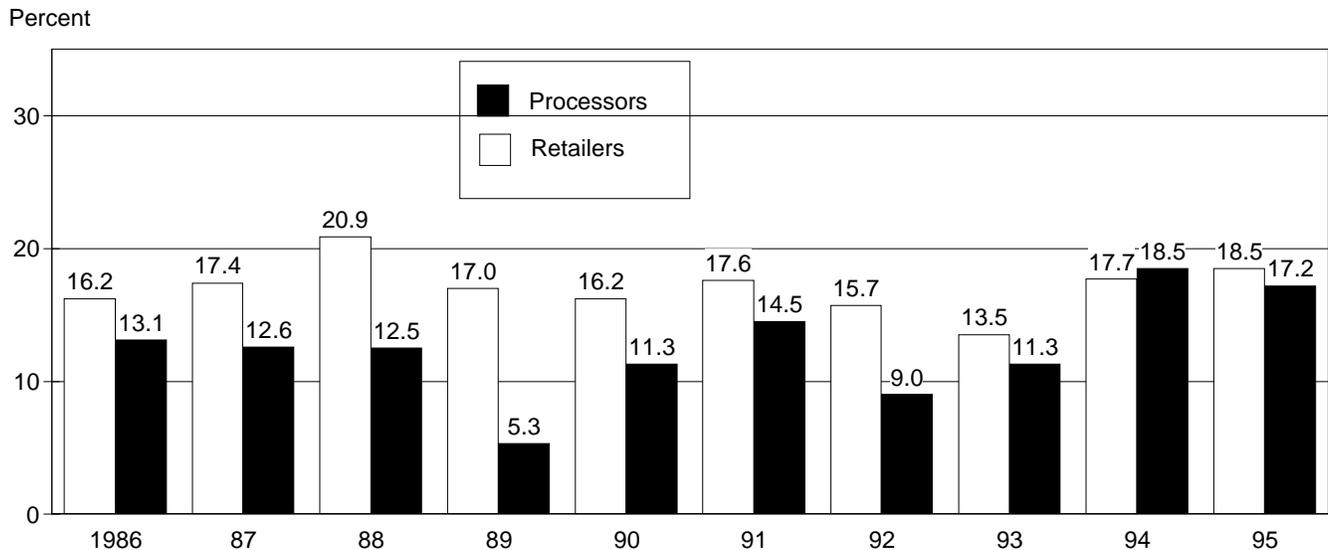


Source: ERS/USDA.

Figure 12

Aftertax profits as a percentage of stockholders' equity

Profit/equity ratio rose for processors and fell for retailers in 1995.



Source: ERS/USDA.

PERFORMANCE

Food Marketing System Performed Well

Capital expenditures in U.S. food processing rose sharply in 1995. Productivity likely increased in many food processing industries in 1995. The investment performance of owners' equity, as measured by increases in common stock prices, sharply outpaced other sectors of the economy for the eighth consecutive year. Processors paid out 55 percent of income as dividends. Global participation continued strong.

Capital Expenditures. Food processors undertook 406 new plant projects in 1995 compared with 329 in 1994 (fig. 13). Total new plant and equipment expenditures for food processing firms, which include nonfood operations, rose from \$13.6 billion in 1994 to \$17.7 billion in 1995 (fig. 14), an increase of 30 percent.

The retail food system continued modernizing and upgrading existing stores, while closing smaller retail outlets. The number of retail grocery stores, which has been falling steadily over the past 50 years, dropped by an estimated 1,000 in 1995. New supermarkets continued to increase in size, averaging about 30,000 square feet per store. An estimated 1,200 new fast-food stores opened in 1995.

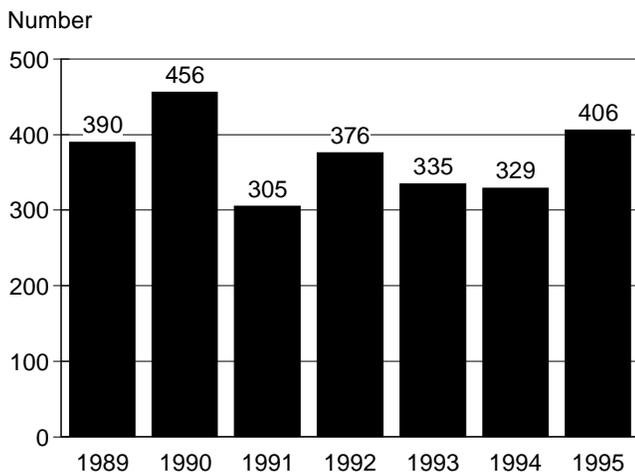
Research and Development. R&D within the food marketing sector is largely conducted in the food and tobacco processing industries. Like most other nondurable manufacturing industries, food is not

R&D-intensive. In 1995, food and tobacco processors likely spent about \$1.8 billion, or about 0.4 percent of sales, on R&D. Only about 6 percent of this amount went to basic research. More than 60 percent of all R&D funds went to processing and new products. However, most R&D in food and tobacco processing is purchased from other sectors, such as food packaging, computer, and machinery firms (much of the technological innovation for food processing comes from these sources). ERS estimates this amount to be about \$1.3 billion.

Productivity. Output per employee in 1993, the most recent data available on productivity, declined in foodservice and food retailing. This index of labor productivity increased in some food processing industries, such as milk, sugar, and beer. An increase in output in most food processing industries, with no increase in employment, suggests an increase in productivity for many food processing industries in 1995.

Figure 13
New plant projects in food processing

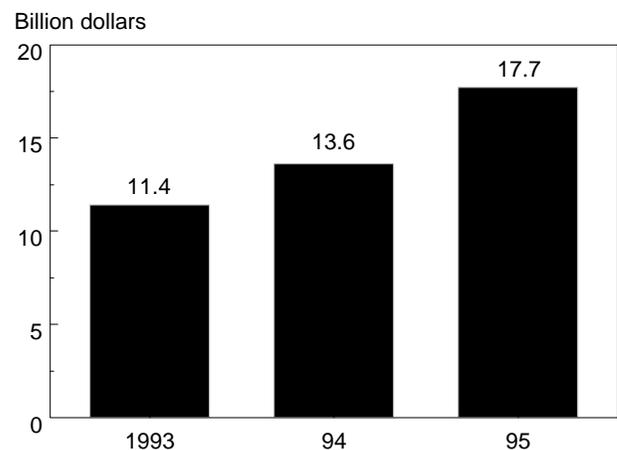
The number of new plant projects rose to 406 in 1995.



Source: ERS/USDA.

Figure 14
Plant and equipment expenditures in food processing

Expenditures rose from \$13.6 billion in 1994 to \$17.7 billion in 1995.

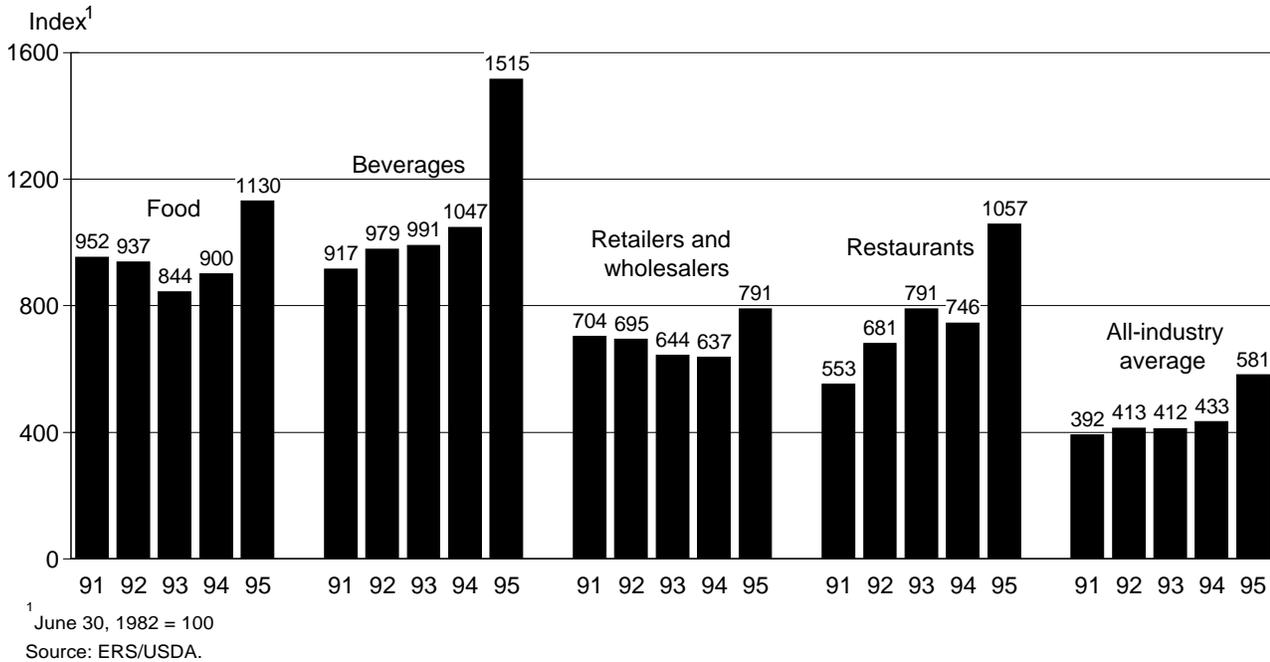


Source: ERS/USDA.

Figure 15

Dow Jones equity market indexes for the food marketing system

Food processing companies have outperformed other industries in the 1990's.



Owners' Equity. Owners (common stockholders) of food marketing companies saw the value of their holdings rise sharply in 1995. The index for food retailers and processors rose 26 percent, while that for beverages rose 45 percent (fig. 15), slightly above the 42-percent increase for fast-food restaurants. The index for all industries rose 35 percent. Since 1982, the food marketing sectors have outperformed the index for all industries.

Dividends. U.S. food firms have always had a relatively consistent dividend payout ratio. U.S. food processors paid out an estimated \$11.2 billion in dividends in 1995 compared with \$9.5 billion in 1994. Nearly 45 percent of income after taxes went to retained earnings, which are used for such projects as new product development, capital expansion, and acquisitions. Food retailers paid over \$800 million in dividends in 1995.

Global Participation. The U.S. food marketing system continued to expand as the world's most global food system. This expansion is measured by the system's foreign trade, foreign investments, and the sales of its foreign subsidiaries. The United States is the world's leading importer and exporter of processed food. The U.S. surplus in processed food trade rose to \$4.6 billion, with about \$29.4 billion in

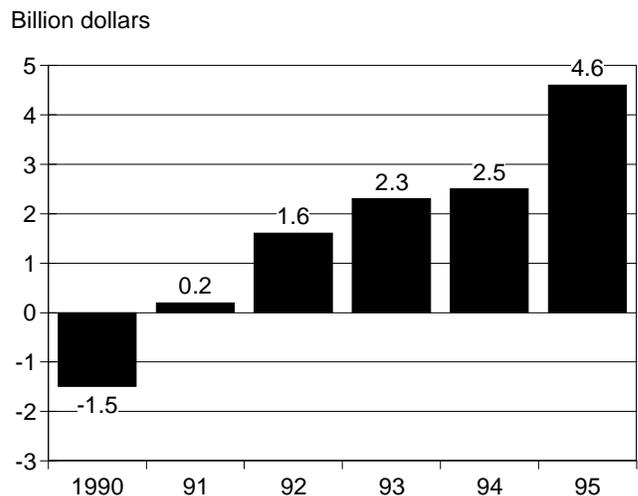
exports more than offsetting \$24.8 billion in imports (fig. 16).

However, trade data per se do not adequately reflect the global presence of U.S. food marketing firms. Many of the world's largest food processing firms expand aggressively in foreign markets by increasing

Figure 16

Trade balance in food processing

U.S. exports exceeded imports by \$4.6 billion in 1995.



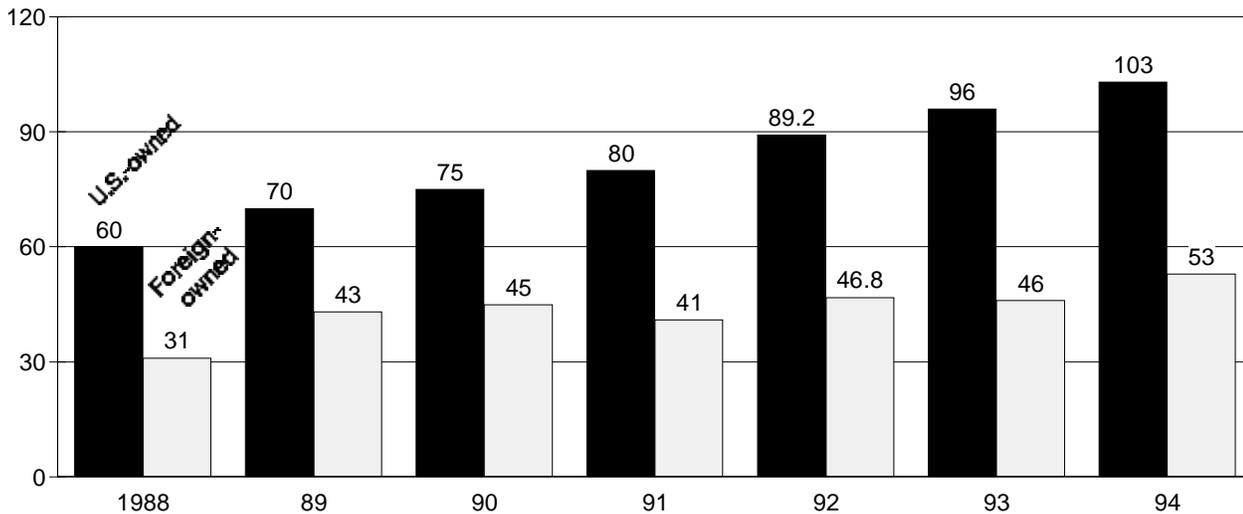
Source: USDA/ERS.

Figure 17

International market in food processing

Sales of U.S. subsidiaries of foreign firms are about half of the sales of foreign subsidiaries of U.S. firms.

Billion dollars



Source: ERS/USDA.

their investments in foreign plants or expanding licensing arrangements with foreign firms to produce and distribute their branded products. While large U.S. food processors export on average only 6 percent of their sales, they receive 27 percent of their total sales from their plants located in foreign countries. Sales from U.S. food processors' foreign subsidiaries were over \$100 billion (estimated) in 1995 (fig. 17),

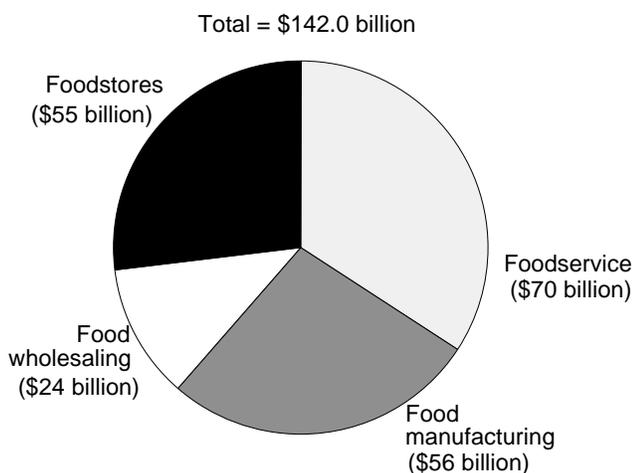
nearly twice the sales of U.S. food processing subsidiaries of foreign firms.

Sales of U.S. affiliates of foreign food marketing firms reached an estimated \$142 billion in 1995 (fig. 18). Sales of foreign affiliates of U.S. food marketing firms were a little higher, reaching \$155 billion in 1995, with the largest portion coming from food processing (fig. 19).

Figure 18

Estimated sales of U.S. affiliates of foreign food marketing firms, 1995

Largest share of sales came from foodstores and restaurants.

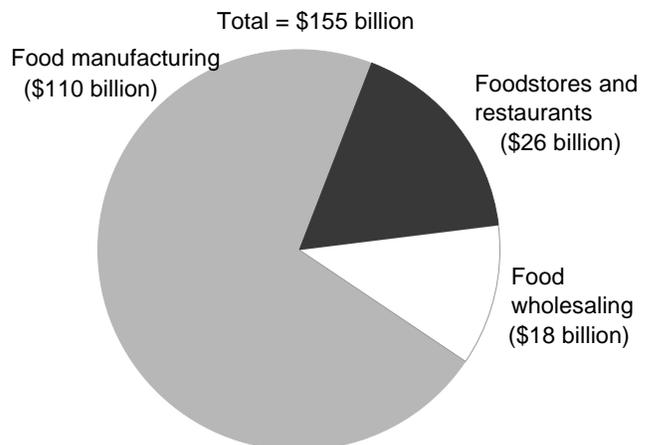


Source: ERS/USDA.

Figure 19

Estimated sales of foreign affiliates of U.S. food marketing firms, 1995

Largest share of sales came from food processing.



Source: ERS/USDA.

Would You Like More Information?

This report is an update of the more detailed report, *Food Marketing Review, 1994-95* (AER-743). The full report includes detailed data on mergers, sales, concentration, advertising, product industries, profits, productivity, plant and equipment expenditures, equity performance, prices, and international performance measures. It also includes charts and a sizable appendix.

What Happened in the Food Marketing System in 1995?

Industry Growth and the Economy

- Sales rose nearly 4 percent.
- The food marketing system's share of national income fell from 11.2 to 11 percent.
- Wages and farm prices were stable: interest rates were mixed; the value of the U.S. dollar was lower.

Structure

- Merger activity was slower than in 1994.
- The number of food processing firms and plants grew for the first time since the 1920's.

Conduct

- Nearly 23,000 new grocery products were introduced.
- Media advertising reached \$10.2 billion.
- Retail prices rose more than in 1994.

Performance

- Profitability from operations up sharply.
- The food marketing system was one of the Nation's most leveraged, but debt levels went up only slightly.
- Owners' equity appreciation reached record high.
- U.S. trade surplus in processed foods skyrocketed.
- The number of new plant projects rose sharply.