Canning study: Impact of new public buying habits

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CANNING STUDY

impact of new public buying habits

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Canners and consumers of fruit and vegetables in the 1980's may soon feel a bit like an overripe tomato squeezed from al sides, especially by inflation. The only difference is that the tomato may end up in a good spaghetti sauce.

Inflation is, however, only one of the pressures affecting the canned goods industry at the beginning of the 1980's, according to a recent study sponsored by Touche Ross & Co. Energy shortages and government regulations are also causing changes in competition and the structure of the canning industry—changes that will make the grocery shelf in 1990 look quite different than now.

The authors of the study, Dr. Ray Goldberg of Harvard Business School and Leonard Wilson of Agribusiness Associates, have spotted trends that will be visible at times to the consumer—and certainly to the economist. It is the growers and processors who will be the most affected.

In the next decade, the study suggests, consumers will change their food-buying habits in order to coax more purchasing power from their budgets. As this changing demand impacts supplies, the variety of sizes, shapes, labels, and products will probably diminish.

Thus, the grocery shopper in 1990 could see fewer brands to choose from, and those brands may very well belong to the supermarket chain rather than to a national-brand processor. The shelves could also display more staple products and fewer high-convenience, premium-priced items. Such a difference in

price may often send the shopper from the canned-goods aisles to the produce section. And in general, the consumer will eat at home more while dining out less than he did in the 1970's.

What forces are causing these changes? Some of the trends more obvious to the economist will be less visible to the consumer. Food prices will outpace general inflation. Per capita food consumption will continue its recent slow growth. Food purchases as a percent of disposable income will, after many years of decline, become constant. And canned food products will no longer be considered relatively inexpensive.

Outlook for Food Processors

For the food processors, the outlook appears distressing. Faced with rising costs and slow growth in demand, they will become fewer in number and more diversified. But more importantly, they will not have the finances necessary to make investments that improve productivity.

A fundamental trend is behind this forecast: canners continue to lose their competitive position in a basically mature industry. Using tomato canners as an example, since 1974 their share of the retail price of a can of tomatoes has shrunk from 65 percent to 58 percent. When the retail price rose 47 percent between 1974 and 1979, the canner's price went up only 31 percent, while the wholesaler's rose by 131 percent.

If anything, this trend has intensified recently. Between 1977 and 1979, while the price to the consumer went up 18 percent, the wholesaler's and retailer's spread went up 147 percent and 53 percent, respectively. But the canner's price remained the same. Exhibit 1 shows how the price of a can of tomatoes is apportioned as the product moves from the fields to the grocery shelf.

Inflation, Energy, and Regulation

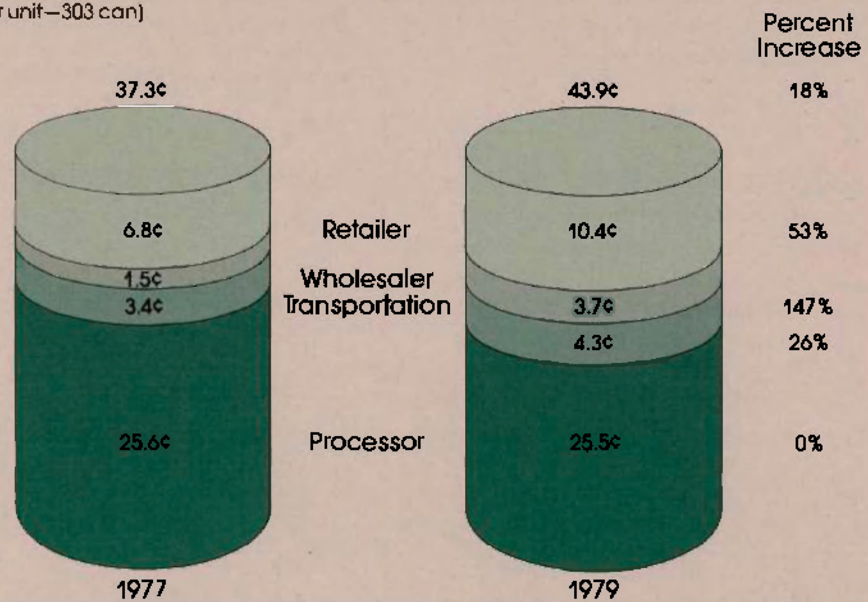
The canners are receiving—and, if current trends continue, will continue to receive—an increasingly smaller portion of the retail price because of unfavorable factors originating outside the factory gates: inflation, soaring energy costs, and increased government regulation.

■ Inflation not only has the usual effect of increasing cost pressures and raising prices, but another one as well. In a seasonal processing industry, inventory is acquired once per year—at the end of the packing season. Financing that inventory is impacted in two ways by inflation: first, the higher cost product raises the dollar value of the inventory; second, inflation-induced higher interest rates increase the rate charged to finance inventory.

■ In addition, energy costs have increased the cost of transporting the finished goods from the production facility to the point of heaviest consumption, a distance which increased during the 1960's and 70's. While fruit and vegetable canning is increasingly concentrated in California, where 87 percent of the tomatoes are processed, most of the consuming population (65 percent) is located in the northeastern United States. Dramatically higher fuel costs thus make the transportation component highly visible. Higher prices also have increased packaging costs, since a metal can requires relatively more energy to produce than glass, retort pouches, or paper packages. Among other things, this can make fresh and frozen produce prices more attractive.

■ Finally, government regulation can upset the competitive balance among canners. The cost of complying with government regulation cannot be easily absorbed in the

Retail Prices and Marketing Spreads
California Whole Canned Tomatoes, 1977-79 **Exhibit 1**
(¢ per unit—303 can)



Projected Structure of Commodity System
for Processing Tomatoes, 1990 vs. 1979 **Exhibit 2**

Value (million $) 1979 est.	Value (million $) 1990 proj.		% of Final Consumption 1979 est.	% of Final Consumption 1990 proj.
$ 388	$ 670	Farm Production	12.5%	8.9%
76	160	Assembly and Delivery	2.4	2.2
$ 464	**$ 830**	**Cost as Delivered to Processing Plant**	**14.9%**	**11.1%**
$ 533	$1,325	Packaging	17.1	17.7
343	940	Other Purchased Materials	11.0	12.4
519	655	Gross Value Added*	16.7	8.7
$1,859	**$3,750**	**Processor Sales**	**59.7%**	**50.0%**
$ 294	$ 960	Transportation	9.4%	12.8%
253	730	Wholesaler	8.1	9.7
710	2,060	Retailer	22.8	27.5
$3,116	**$7,500**	**Value at Final Consumption**	**100.0%**	**100.0%**

*Includes labor costs, overhead, and return on investment. Source: Estimated by Agribusiness Associates, 1980.

overhead of a small- or medium-sized business. In another example, canners who are located in air quality maintenance areas can find that restrictions on emissions can limit how they utilize certain facilities.

The Next Ten Years

If this trend continues, the canner's portion of the retail price may shrink from 60 percent to 50 percent by 1990, according to Professor Goldberg and Mr. Wilson. The grower's share, too, will diminish, but nearly all the "downstream" handlers—the transportation companies, the wholesalers, and the retailers—will get increased shares. As shown in Exhibit 2, the transportation portion would increase from 9.4 percent to almost 13 percent, the wholesaler's portion to almost 10 percent, and the retailer's from 22.8 percent to 27.5 percent.

Increased Competition

The existence and future threat of reduced margins have created new competitive pressures. No longer can a processor count on success by being the lowest-cost producer in the industry. And the competition is both horizontal and vertical. It comes from other processors as well as from growers, wholesalers, and retailers.

Horizontally, canners are fighting for a market share not only with other canners but with fresh and frozen food processors as well. Excess processing capacity, built during a period of sharply increasing demand, has heightened competition among canners themselves and prevented them from passing through increased costs. Moreover, canned goods are losing their relative price advantage in the grocery store to fresh produce and frozen products. As a result of this increased competition, one can expect to see a trend by canners to become part of conglomerates or to diversify their operations. Both strategies will be designed to reduce dependence on canning operations.

Vertically, canners face competition from both growers and downstream distributors. Growers find that the production of fruit and vegetables for processing provides the most attractive use of their land, and consequently they are interested in assuring a market for their products. As a result, they are forming cooperatives and purchasing processing facilities.

"As an industry, we have been in a very low margin business. We have learned to operate by our wits, and the fact that we are still in business is, I think, a success story. We have done a good job in controlling costs in the controllable areas. It is in the non-controllable areas that we need help."

BOB GIBSON
president
California Canners and Growers

"We are Don Quixotes, as far as I'm concerned, to say that we're going to shed [government] bureaucracy."

BILL ALLEWELT
president
Tri/Valley Growers

At the other end of the commodity system, retailers and wholesalers are trying to increase their share of the retail market with lower-priced generic and private-label products. As consumers cope with inflation by trying to buy more with the shrinking dollar, they will turn to these less expensive private labels, and processors will find it harder to earn a premium for their established labels.

From the processor's position in the middle of the production cycle, their operations will be increasingly separated into two stages. The first-stage processing will occur near the farming centers—and may increasingly be operated by grower coops. The semi-finished product can then be transported more cheaply in bulk form to the final product conversion stages located near significant consumption centers, such as the northeast. There, others will finish, pack, and label the product.

Future Industry Direction

At a time when canners are experiencing these intensive competitive pressures, revenue increases will generally be the result of higher prices rather than of a real growth in consumption. These competitive pressures have thus reduced the economic vitality of the canning industry, and will continue to do so unless underlying trends are reversed.

The challenge to the canning companies is going to be to understand the dynamics of the consumer's needs in an inflationary environment. Those needs are, essentially, that products be consistent in quality, versatile, and yet reasonably priced. Success will come only to those that can integrate those factors external to the industry—such as inflation, energy costs, government regulation—with their own planning efforts to meet consumer needs.