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An Economic Research Service Report

The Food Marketing System in 1994

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August 1995

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In this report...Total sales in the U.S. food marketing system grew by 4.2 percent in 1994 to nearly \$800 billion. Sales at foodstores accounted for 42 percent of that, sales at restaurants 34 percent, and sales of nonfood items and alcoholic beverages 24 percent. Value added by the food system represented about 81 cents of each food dollar spent. Food marketers introduced nearly 15,000 new food items in 1994. Profits for both food processors and food retailers continued at record levels. Americans spent just 10.7 percent of household income to buy food in 1994, a new low.

This report analyzes and assesses yearly developments in the Nation's food marketing system. These developments relate to industry growth, conduct, performance, and structure of the institutions—food processors, wholesalers, retailers, and foodservice firms. *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 number of companies and establishments.

Food Marketing Highlights in 1994

Industry Growth and the Economy

- Sales grew about 4 percent.
- Food marketing system's share of personal income fell to 10.7 percent.
- Workers wages and farm prices stable; interest rates rose and value of U.S. dollar fell.

Structure

- Value of mergers and leveraged buyouts tripled.
- Number of food processing plants rose by about 200 (since 1987).

Conduct

- Retail prices rose modestly.
- Competition intense for retail shelf space and consumer acceptance.
- Over 20,000 new grocery products introduced.
- Advertising to consumers rises sharply.

Performance

- Profitability rose for both retailers and for manufacturers.
- Debt levels rose 5 percent in food processing and retailing.
- Owners' equity (common stock values) rose.
- Trade surplus of \$2.5 billion in 1994 in food processing.

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Sales Strong

Food marketing system sales reached \$791 billion in 1994 (up 4.2 percent), including \$334 billion in retail food sales and \$89 billion in alcoholic beverages.

Economic conditions were favorable to U.S. food markets in 1994. These factors contributed to an increase in real sales (sales adjusted to reflect price increases) of about 1.8 percent for the food marketing system in 1994. Total sales rose 4.2 percent in 1994, exceeding the 2.4-percent increase in food prices. Food purchases by households dipped to 10.7 percent of disposable personal income, continuing an unbroken string of such declines in the 1990's.

General Economy. Gross Domestic Product adjusted for price increases rose 4 percent. Labor and farm price increases were modest (see next section). Although interest rates rose sharply, they still averaged below 1991 levels. Total employment rose by 3.7 million in 1993. The unemployment rate fell from 6.8 percent in 1993 to 6.1 percent. Real per capita disposable income rose for the third consecutive year.

Sales. The improvement in the general economy was reflected in the food system's sales, which rose by 1.8 percent (in real terms) in 1994. The food marketing system's share of disposable personal income declined to 10.7 percent, as disposable income rose (fig. 1). Total sales of items purchased at foodstores and foodservice establishments, packaged alcoholic beverages, drinks purchased at eating and drinking places, and nonfood items purchased in retail foodstores reached an estimated \$828 billion.

Product Mix. About \$334 billion was spent for food in retail foodstores (fig. 2) compared with \$323 billion in 1993. Foodservice sales increased nearly 6.1 percent to \$268 billion.

The alcoholic beverage market, accounting for about 11 percent of sales in the food marketing system, continues to reflect lower consumption. Alcoholic beverage sales accounted for \$89 billion of food marketing sales in 1994 versus \$86 billion in 1993. Nearly \$50 billion was in the form of packaged alcoholic beverages, while alcoholic drinks served in restaurants and other institutions amounted to nearly \$39 billion. Distilled spirits in 1994 averaged about 31 percent of total alcoholic beverage consumption,

while beer will likely account for nearly 56 percent. Wine sales likely captured about 13 percent of the alcohol total.

The nonfood component of retail sales amounted to about \$100 billion in 1994. Nonfood groceries include tobacco, health and beauty aids, detergents, paper products, 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 into the foodservice category.

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

Note: Data in this report are not comparable with data reported in previous years, because the data series have been revised to exclude food that does not enter commercial marketing channels.

Figure 1

Food marketing system's share of disposable personal income

The food marketing system's share of income was 10.7 percent in 1974

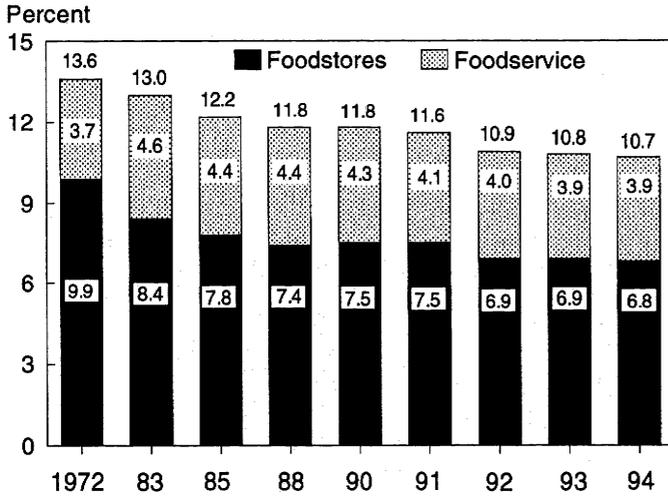
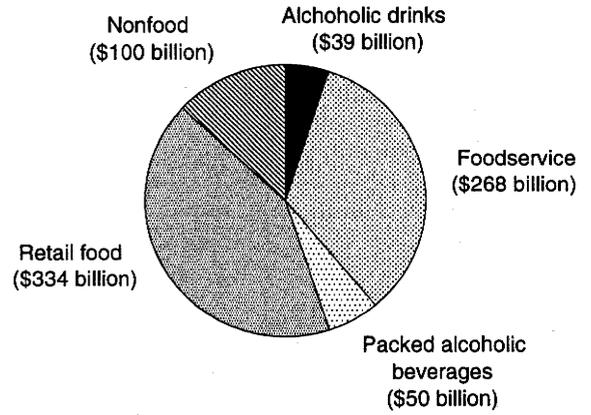


Figure 2

Food marketing sales, 1994

Sales rose 3.4 percent to \$791 billion in 1994, Food service sales (primarily restaurants) totaled 80 percent of foodstore sales.



Wage and Price Stability Holds Down Costs for 12th Consecutive Year

Interest rates rose sharply but stable wages and prices held down costs for the 12th consecutive year in 1994. The food system purchased an estimated \$106 billion in U.S. agricultural commodities, \$23 billion in foreign agricultural commodities, and \$9.5 billion in seafood products in 1994. The system then added an estimated \$603 billion in value to these raw products.

The economic climate was favorable to the food marketing system for the past dozen years in terms of costs. The food system is labor-intensive and sensitive to farm prices. The system is also highly leveraged and global intensive. Consequently, movements in wages and prices, interest rates, and the value of the U.S. dollar affect the performance of the food sector.

Prices. The Producer Price Index (PPI) reflected modest price increases for purchased food and feed inputs for each sector of the food marketing system in 1994. The PPI for finished consumer foods, an indicator of changes in prices paid by retailers, wholesalers, and restaurateurs to food manufacturers, averaged only 0.8 percent higher in 1994 than in 1993 (fig. 3). The PPI for intermediate foods and feeds, an indicator of changes in prices food processors pay one another, rose 2.5 percent in 1994. The PPI for crude foodstuffs, or prices paid by food manufacturers, actually fell 1.8 percent in 1994.

Labor and Other Costs. For the 12th consecutive year, labor costs, which include hourly earnings and fringe benefits, constituted the major expense item for the food marketing system. The food marketing system had about 12.8 million full- and part-time employees in 1994, about 300,000 more than in 1993. More than 7 million workers were employed in food service, and about 3.2 million were employed in food retailing. About 1.6 million workers were employed in food processing, and nearly 870,000 worked in grocery wholesaling.

Average hourly earnings and benefits in food marketing increased 2½ percent in 1994. Packaging costs were up 3.8 percent. Transportation costs rose 2 percent in 1994, while energy costs fell 1.5 percent.

Advertising. The food system, the economy's largest advertiser, faced nearly stable advertising prices for both network and spot radio and television in 1993. The overall index of advertising prices rose about 4 percent.

Interest. Interest rates in 1994 rose to their highest level in 3 years. The prime interest rate, which averaged 6 percent in 1993, rose to 7.15 percent in 1994. Short-term rates also rose, as reflected in the increase in 3-month Treasury bills, from an average 5.02 percent in 1993 to 4.29 percent in 1994. Long-term corporate bond rates averaged about 7.97 percent in 1994, compared with 8.22 percent in 1993. By yearend 1994, the prime rate had risen to 8½ percent, while the rate on 3 month Treasury bills reach 5.64 percent.

Value of the U.S. Dollar. The value of the U.S. dollar fell in 1994. The trade-weighted value of the U.S. dollar averaged 91.6 compared with 93.2 in 1993. This decline raised the value of remittances of overseas profits of American food companies. The lower valued U.S. dollar would also make 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 \$110 billion in animal and crop products from the U.S. farm sector, about two-thirds of domestic production, USDA's Economic Research Service (ERS) estimated in 1994. An additional \$27½ billion was spent on imported agricultural products, and \$9½ billion was spent on seafood. To this base of \$148 billion in raw agricultural and fishery products, the food system added an estimated \$603 billion in value in 1994, compared with \$587 billion in 1993 (fig. 4). Food processors added about \$120 billion in 1994, while wholesalers, retailers, and transportation firms added another \$160 billion. The contribution of 400,000 separate eating and drinking places to value added was nearly \$118 billion in 1994.

Figure 3

Producer and retail price index changes for food marketing system, 1993-94

The PPI reflected modestly higher input prices paid by most channels of the food marketing system in 1994.

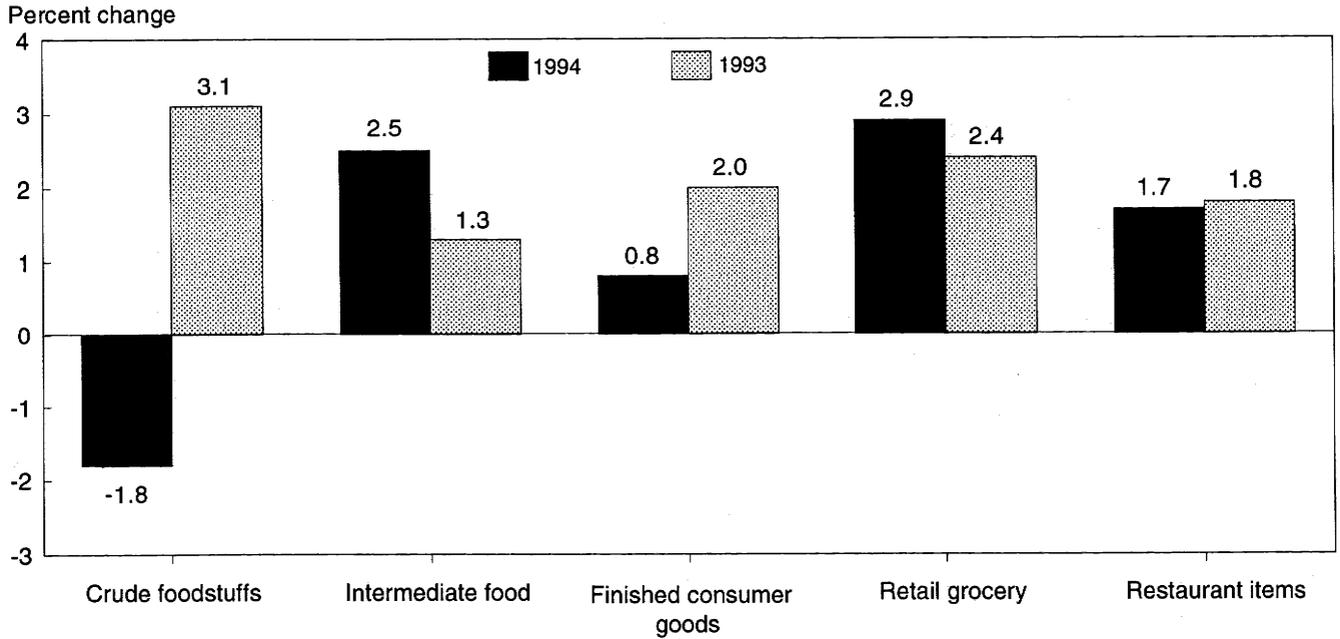
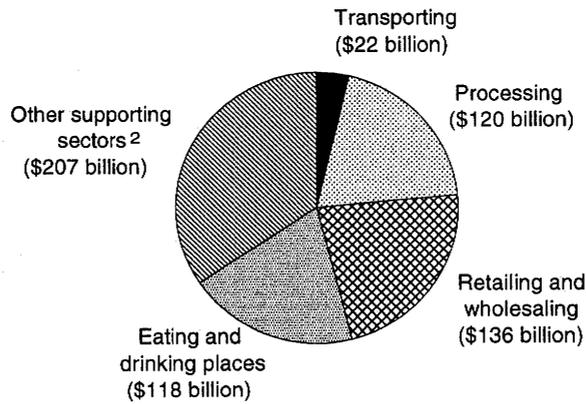


Figure 4

Estimated value added in food marketing system, 1994

The U.S. food marketing system added about \$603 billion¹ in value to raw products.



1/ Revised from previous years to reflect new benchmarking.

2/ Includes auxiliary activities, such as packaging, needed to provide food to final user.

Merger Activity Rose in 1994

The number of mergers remained the same in 1994. The value of large recorded mergers nearly quadrupled, rising from \$3 billion in 1993 to over \$11 billion.

New merger and leveraged buyout transactions in the food marketing system rose in 1994 for the third consecutive year. The number of acquisitions (purchase of a company or subsidiary) rose from 485 in 1993 to 522 in 1994 according to the Food Institute (table 1). These data include merger activity in such related industries as packaging and supplies, which rose sharply. Excluding that activity among nonfood marketing firms, the number of mergers, acquisitions, and divestitures within the food marketing system stayed about the same as in 1993 (fig. 5). An increase in the number of mergers in food retailing, wholesaling, and foodservice offset a decline in food processing mergers.

The value of these transactions, however, rose from \$3 billion in 1993 to \$11.5 billion in 1994, the highest level since 1989 (fig. 6). Food processing ranked seventh among all manufacturing industries in the value of mergers. Leveraged buyout activity was minimal in 1994. Food wholesalers ranked second among all wholesalers in the number of mergers, while food retailers ranked fourth.

Despite the merger activity and consolidation, the number of food processing plants appears to be in-

creasing. According to the 1992 Census of Manufacturers, the number of new processing plants rose from 20,583 in 1987 to 20,792, a gain of 209. A sharp increase in prepared food, sugar, and bakery products establishments more than offset declines in dairy, soft drinks, and fats and oils.

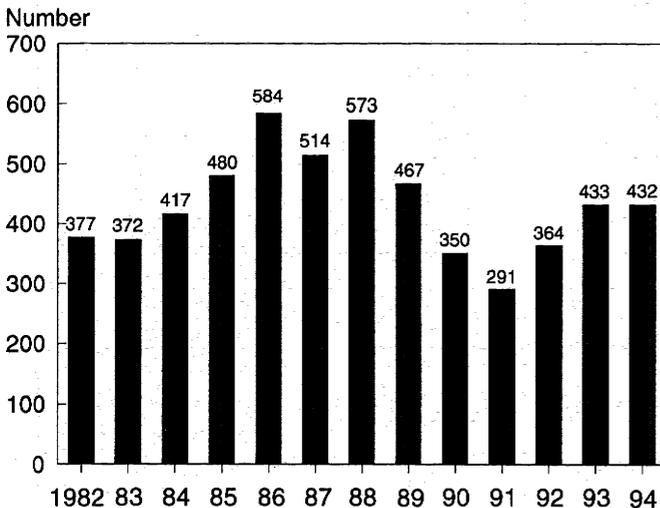
Measures of Structural Development

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**—The 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.

Figure 5
Food marketing mergers and acquisitions

The number of mergers remained about the same as in 1993.¹



¹ Excludes some acquisitions by nonfood marketing firms that are included in table 1.

Figure 6
Value of food marketing mergers and leveraged buyouts costing more than \$100 million

Merger value was halved from \$6 billion in 1992 to \$3 billion in 1993, but rose to \$11 billion in 1994.

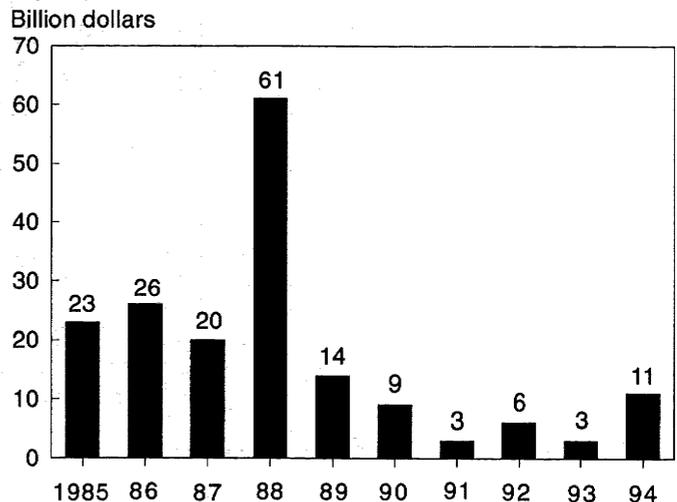


Table 1—Food business mergers and acquisitions*There were 522 mergers in 1994, the most since 1989.*

Category	1994	1993	1992	1991	1990	1989
	<i>Number</i>					
Agricultural cooperatives	6	5	9	4	2	4
Bakers	16	6	9	4	12	19
Brewers	1	3	1	1	1	3
Brokers	9	8	14	8	9	14
Confectioners	2	9	6	7	2	10
Dairy processors	17	15	14	12	16	14
Diversified firms with interests in the food industry	7	9	6	5	10	4
Food processing firms	106	114	84	73	66	107
Foodservice vendors	14	12	19	31	22	29
Hotel and lodging companies	2	2	2	2	3	6
Meatpackers	14	14	12	8	11	11
Nonfood marketers selling through supermarkets	1	2	6	4	5	7
Packaging suppliers	14	8	21	15	26	25
Poultry processors	7	3	9	3	10	5
Primary products companies	21	21	36	47	24	47
Restaurant and foodservice concerns	71	72	57	33	42	57
Retailers:						
Convenience stores	10	5	4	9	15	16
Supermarkets	42	19	15	16	15	26
Others	17	18	15	9	9	9
Seafood processors	3	2	6	6	4	4
Snack food processors	9	7	11	1	5	6
Soft drink bottlers	10	18	9	3	12	12
Sugar refiners	1	4	0	1	0	1
Suppliers to the food industry	0	0	0	0	5	3
Unclassified and private investors	39	50	52	24	23	21
Wholesalers	29	25	24	10	13	21
Foreign acquisitions:						
Of U.S. firms/subsidiaries	44	31	18	20	48	55
By Canadian firms	10	3	9	9	5	10
Total	522	485	468	365	415	556

Table 2—Number of food processing establishments*The number of bakeries rose by more than 10 percent, more than any other category. The number of beverage manufacturers declined by more than 6 percent, the greatest drop in any category.*

Industry	1992	1987	Change	
	<i>Number</i>			<i>Percent</i>
Food	20792	20,583	209	10.1
Meat	3,237	3,240	-3	.1
Dairy	2,024	2,366	-106	-4.55
Fruits and vegetables	2,046	1,918	128	6.7
Grain mill products	2,619	2,607	12	.5
Bakery products	3,151	2,850	301	10.5
Sugar	1,130	1,075	55	5.1
Fats and oils	543	586	-43	7.3
Beverages	2,066	2,211	-145	-6.5
Other prepared foods	3,976	3,730	246	6.6

Price and Nonprice Competition Vigorous

Food prices rose nearly 2.5 percent in 1994. Nonprice competition was keen for shares of the food marketing dollar as 20,000 new grocery products were introduced and advertising expenditures rose by \$800 million (nearly 8 percent).

Less than 9.5 percent of the Nation's gross domestic product (GDP) was generated by the food marketing system in 1994, compared with about 12 percent in 1984. And, while the value added by the food system has increased in dollar terms, a much greater portion of this output is supplied by fewer and larger firms. Although food marketing is thus more concentrated, firms in each market sector sought to acquire or maintain market shares through both price and nonprice competition.

Consumer prices for food increased 2.4 percent in 1994 compared with 2.2 percent in 1993. In 1994, food prices in grocery stores rose 2.9 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 coffee prices rose 22 percent, contributing significantly to the all-food increase in 1994's Consumer Price Index.

Price competition to gain market shares was apparent in both the retail food and fast-food sectors of the foodservice industry in 1994, where major discounts were given to consumers for the fourth consecutive year. Private label's share of total grocery sales continued to make inroads in 1994. Consumer coupon redemptions were also strong.

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 grocery suppliers introduced 20,076 new grocery products in 1994, an increase of nearly 14 percent over 1993 (fig. 7). Condiments, at 3,271, comprised over a fifth of the 15,006 new food products introduced in 1994. Candy, gum, and snacks accounted for nearly 2,500 new food products, followed by beverages at 2,250. Over 1,600 new bakery and nearly 1,300 dairy products, mostly cheese and ice cream, also found their way to the Nation's grocery shelves in 1994. Together, these five product categories accounted for nearly 60 percent of all new food products in 1993. Most of the new items were line extensions such as new flavors rather than technological or packaging innovations. Products geared to

children continued to increase, as did health-claim products which had fallen in 1993. For the decade ending in 1994, over 140,000 grocery products were introduced on U.S. supermarket shelves.

Food marketing firms spent an estimated \$9.8 billion in direct consumer advertising in 1994, such as electronic and printed media, compared with \$9.1 billion in 1993 (fig. 8). Food processors spent over \$6.5 billion on mass media advertising, while food retailers spent over \$900 million (excluding local newspapers). Restaurants, mostly fast food chains, spent almost 2.3 billion dollars. Coupon redemptions likely accounted for another \$2.5 billion.

Competition was also keen in getting products on the shelves of the Nation's grocery stores in both 1993 and 1994. 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.

Measures of Conduct

The following indicators are used in this section to measure conduct, or competitive behavior, in the food marketing system.

- Price competition
- Nonprice competition
 - Advertising
 - Promotions
 - New product introductions
 - New store formats
 - Menu variety
- Shelf space

Figure 7

New grocery product introductions

Over 15,000 new food products were introduced in 1994; most were extensions of already existing products.

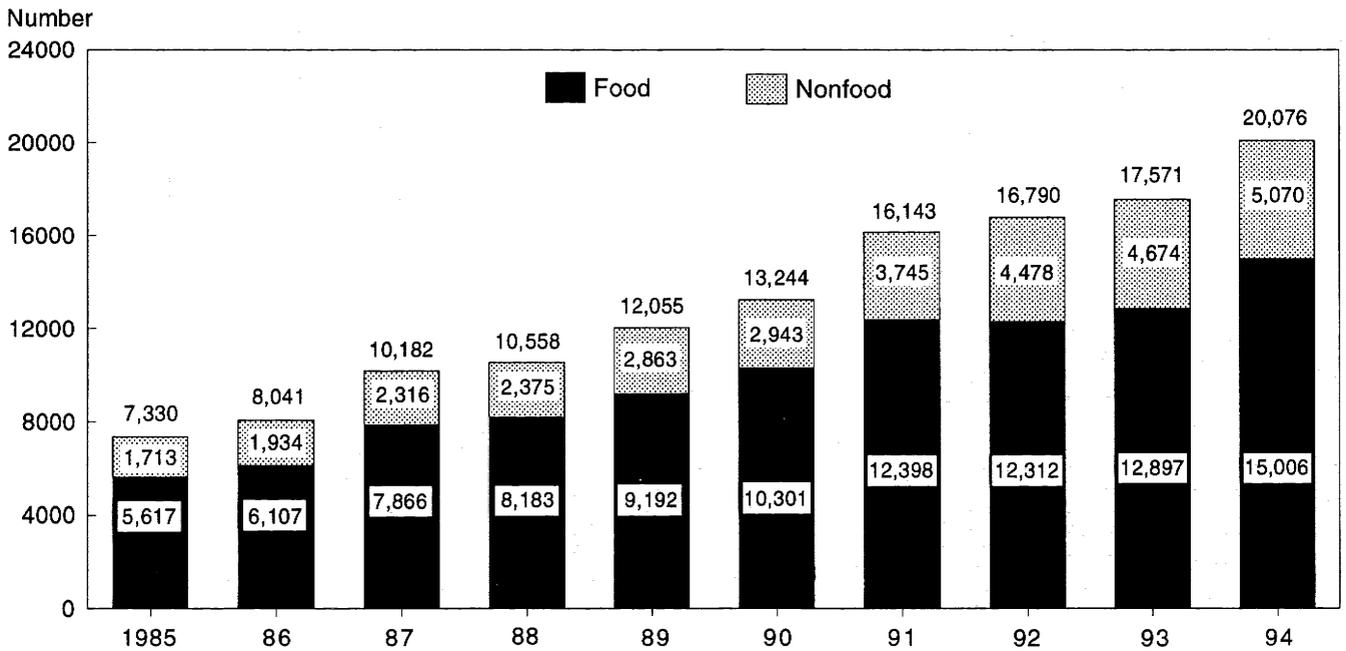
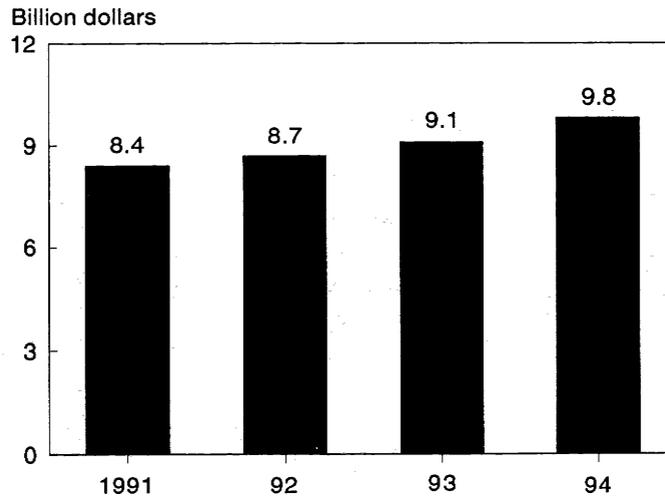


Figure 8

Food-related advertising¹

Food marketing firms spent nearly \$10 billion on direct consumer advertising in 1994.



¹/ Excludes coupons.

Profits Rise

Debt of the Nation's food processors and retailers rose by 5 percent in 1994. Profits rose for both retailers (up 7.5 percent) and processors (up 11 percent).

Total debt rose nearly a billion dollars for food retailers to about \$60 billion in 1994, while debt for food processing rose \$14 billion to \$240 billion. Total liabilities of food retailers and processors rose by \$15 billion in 1994 to \$302 billion (fig. 9). The overwhelming portion of the late 1980's growth in liabilities was due to leveraged (indebted) buyouts and mergers. By 1991, merger and leveraged buyout activity had subsided, and debt had been correspondingly reduced in food manufacturing.

Debt. Food remained one of the most leveraged industries in the American economy through 1994. The equity-to-debt ratio of food manufacturers was 0.92 in the fourth quarter of 1994, compared with 1.38 for all manufacturing. The equity-to-debt ratio for food retailing rose from 0.44 to 0.45 between 1993 and 1994 (fig. 10). By comparison, the equity-to-debt ratio for all retailers was 0.97 during the fourth quarter of 1994.

Profits. Food and tobacco processors' profits from operations rose from the record \$33 billion in 1993 to \$37 billion in 1994 (fig. 11) due to improved cost controls and declines in some key ingredient costs such as live animal prices. Food retailers' profits from operations rose from \$6.4 billion in 1992 to \$6.7 billion in 1993 to a record \$7.2 billion in 1994, reflecting increased volume and cost controls.

Aftertax profits as a portion of stockholders' equity for food processors rose from 13.5 percent to 17.7 percent between 1993 and 1994 (fig. 12). Retailers' aftertax profits amounted to 1.2 percent of sales and 18.5 percent of stockholders' equity in 1994, both up significantly from 1993. However, aftertax profits among both processors and retailers varied significantly. Discerning a true picture of profits is difficult because such a large portion of food sales is controlled by marketing firms.

Measures of Performance

The following indicators are used in this and the following section 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
- Investment performance
 - Common stock prices
 - Owners' equity appreciation
- Participation in the global market
 - Foreign trade balance
 - Foreign investment

Figure 9

Total liabilities of food and tobacco processors and retailers

Debt levels increased again in 1994.

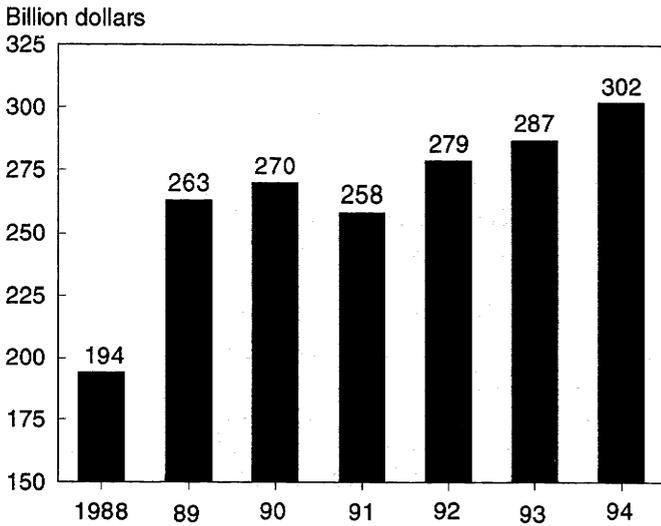


Figure 10

Food system's equity-to-debt ratio

Debt levels increased again in 1994.

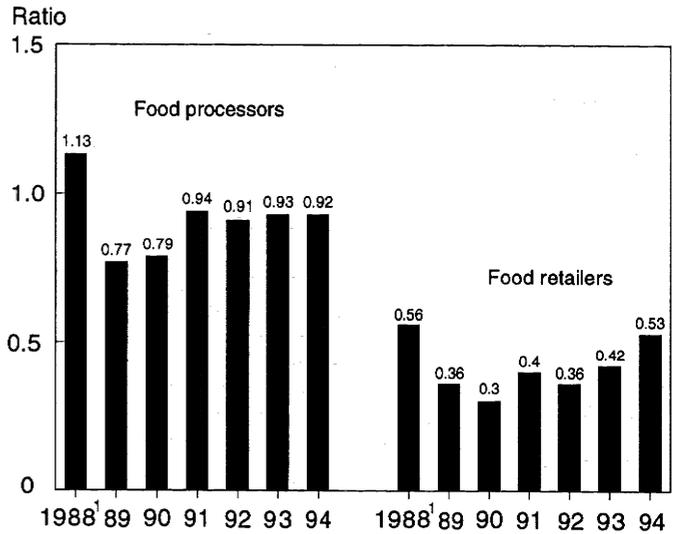


Figure 11

Profits from domestic operations, food processors and retailers

Profits from operations rose for both processors and retailers.

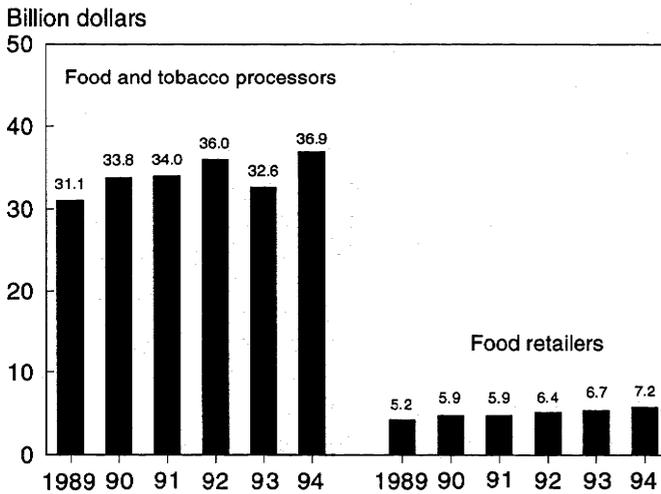
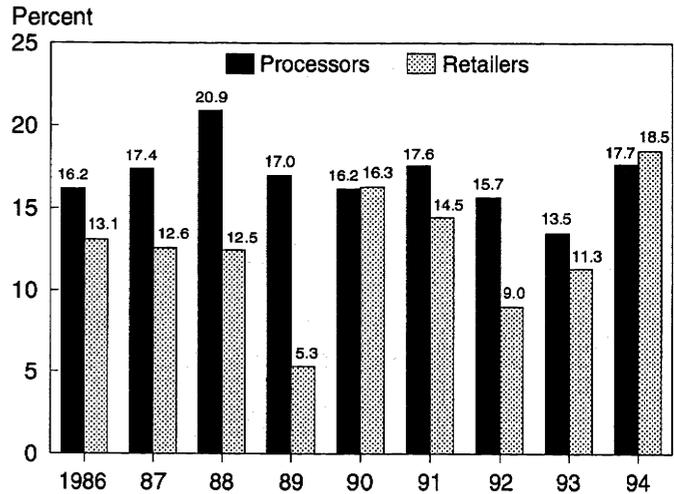


Figure 12

After-tax profits as a percentage of stockholders' equity

After-tax profit/equity ratio rose for both processors and retailers in 1994.



Food Marketing System Performs Well

New capital expenditures in U.S. food processing rose in 1994. The investment performance of owners' equity, as measured by increases in common stock prices, increased for food processors and retailers. Processors paid out 40 percent of income as dividends. Foreign investment and trade continued at high levels; processed food trade showed a surplus.

Capital expenditures, research and development, productivity, owners' equity, and global participation are important performance measures.

Capital Expenditures. Food processors undertook 329 new plant projects in 1994, compared with 355 in 1992 (fig. 13). However, total new plant and equipment expenditures for food processing firms, which include some nonfood operations, rose to nearly \$14 billion in 1994 (fig. 14).

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 1994. New supermarkets are averaging about 30,000 square feet per store.

Research and Development. R&D within the food marketing sector is largely conducted in the food and tobacco processing industries. Like most other non-durable manufacturing industries, food is not R&D intensive. Food and tobacco processors spent about \$1.6 billion, or about 0.4 percent of sales, on R&D in 1994. 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). USDA's Economic Research Service estimates this amount to be about \$1.2 billion.

Owners' Equity. Owners (common stockholders) of food marketing companies saw the value of their holdings rise sharply in 1994. The index for food processing rose 6.6 percent, while that for beverages rose 5.6 percent (fig. 15). The food retailers and wholesalers index stayed about the same, while the restaurants index dropped.

Dividends. U.S. food firms have had a consistent dividend payout ratio. U.S. food processors paid out an estimated \$9.5 billion in dividends in 1994. Over 40

percent of aftertax income went to retained earnings, which are used for such projects as new product development, capital expansion, and acquisitions. Food retailers paid nearly \$700 million in dividends in 1994.

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 one of the world's leading importers and exporters of processed foods. The U.S. surplus in processed food trade rose to \$2.5 billion, with about \$25.8 billion in exports more than offsetting by more than \$23.3 billion in imports (fig. 16).

However, trade data do not adequately reflect the global presence of U.S. food marketing firms. Many of the world's largest food processing firms have aggressively expanded in foreign markets by increasing 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 exported on average only 4 percent of their sales, they received 27 percent of their total sales from their plants located in foreign countries. Sales from foreign food processing subsidiaries of U.S. firms were about \$100 billion (estimated) in 1994 (fig. 17), about 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 \$133 billion in 1994, with the largest portion (44 percent) coming from food retailing (fig. 18). Sales of foreign affiliates of U.S. food marketing firms were a little higher, reaching \$140 billion in 1994, with the largest portion (71 percent) coming from food processing (fig. 19).

Figure 13

New plant projects in food processing

The number of new plant projects fell from 376 in 1992 to 335 in 1993 and 329 in 1994.

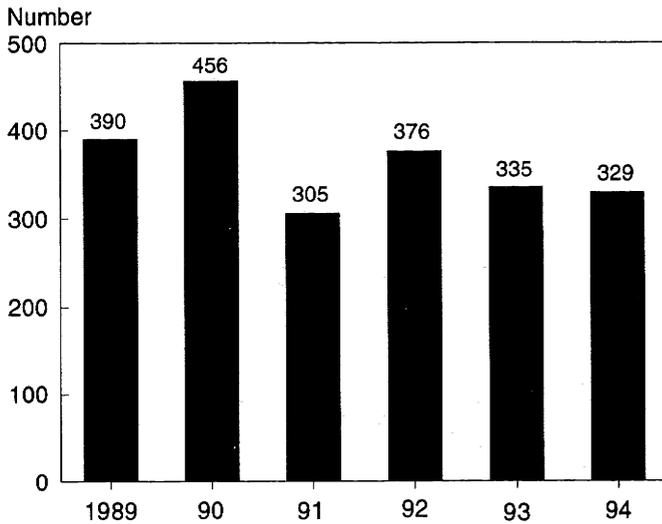


Figure 14

Plant and equipment expenditures in food processing

Expenditures rose from \$11.4 billion in 1993 to \$13.6 billion in 1994.

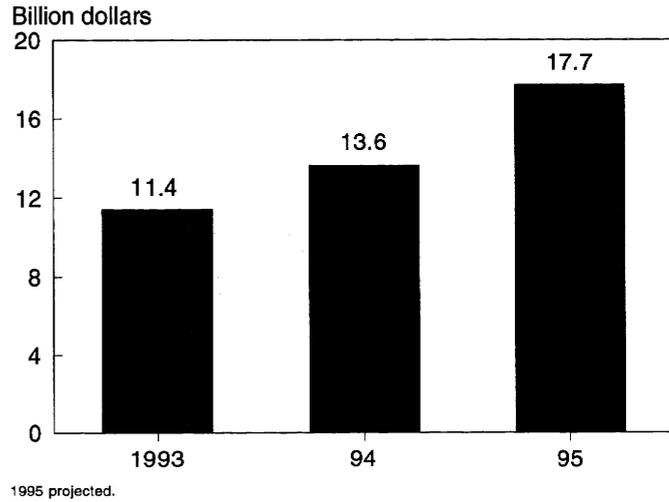
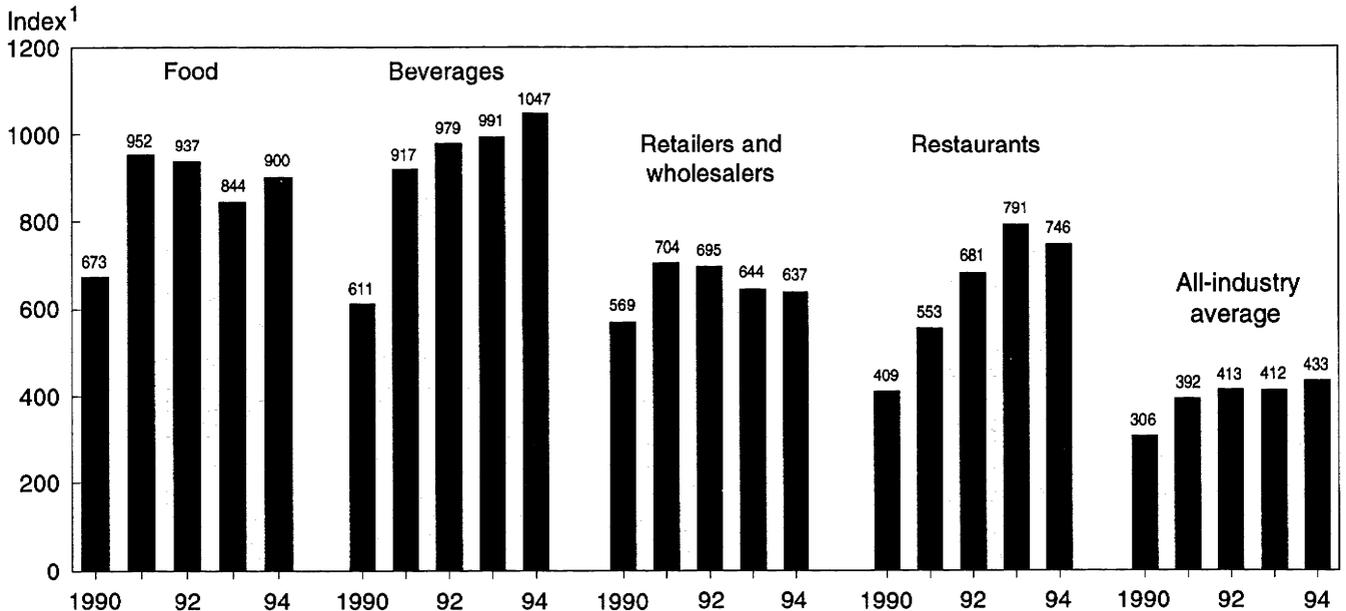


Figure 15

Dow Jones equity market indexes for the food marketing system

Food processing companies' indices rose sharply in 1994, while restaurants' declined.



1/ June 30, 1982 = 100.

Figure 16
Trade balance in food processing

U.S. exports exceeded imports by \$2.5 billion in 1994.

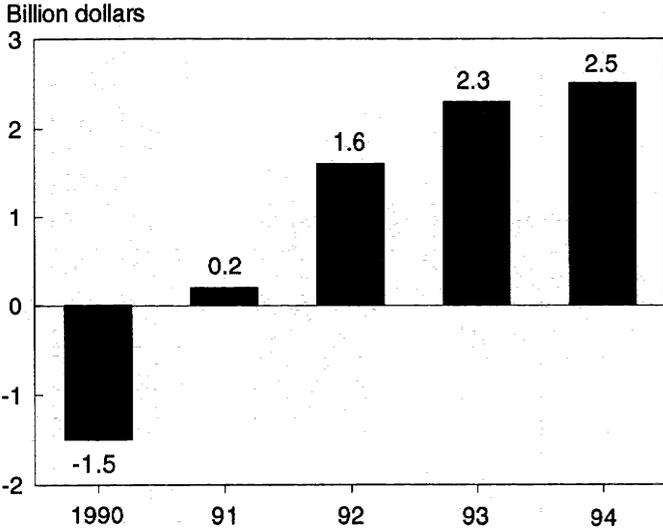
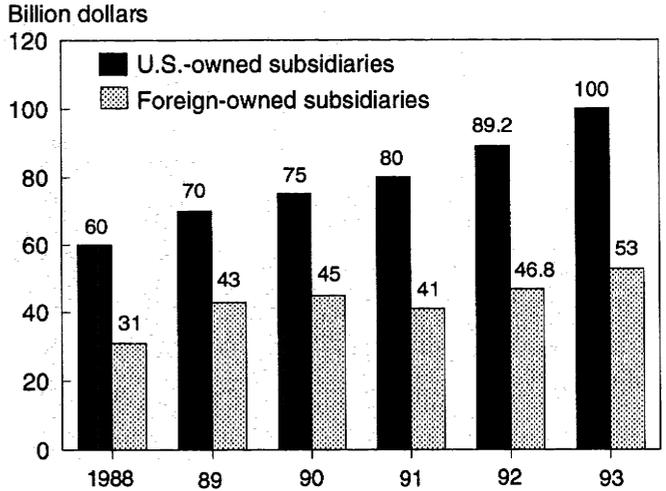


Figure 17
International market in food processing

Sales of U.S. subsidiaries of foreign firms are about half the sales of foreign subsidiaries of U.S. firms.¹



^{1/} Estimated.

Figure 18
Estimated sales of U.S. affiliates of foreign food marketing firms, 1994

Largest share of sales came from foodstores and restaurants.

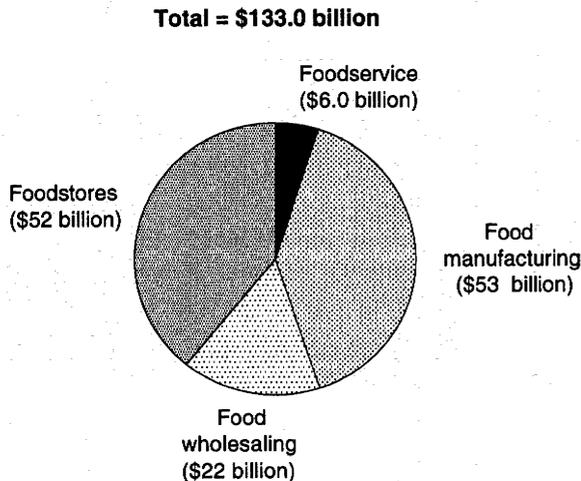
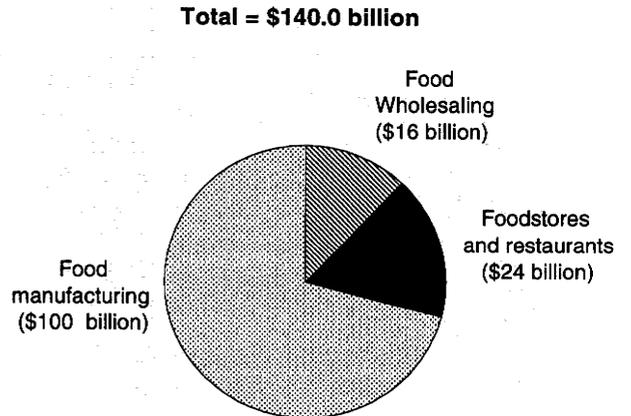


Figure 19
Estimated sales of foreign affiliates of U.S. food marketing firms, 1994

Largest share of sales came from food processing.



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