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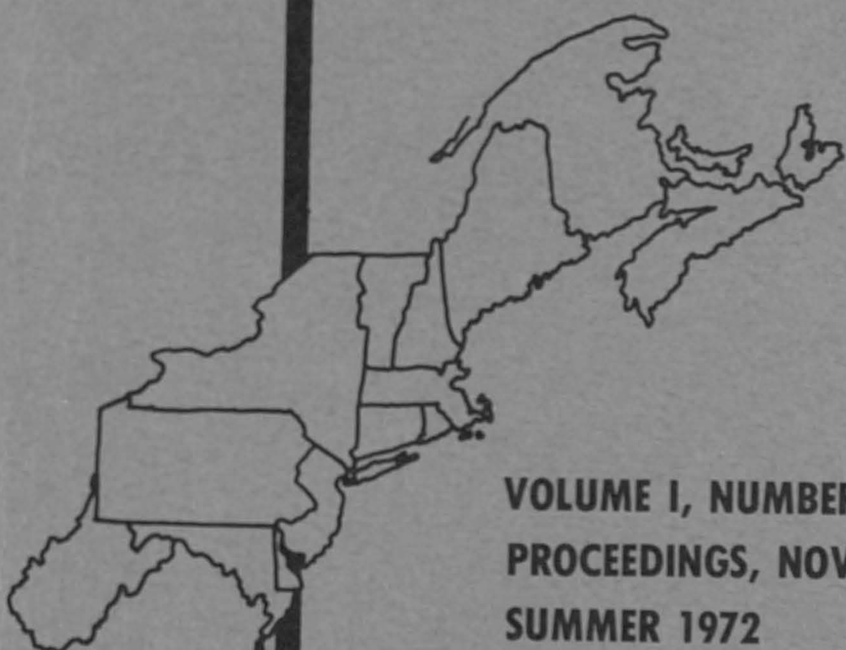

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PUBLIC REGULATION OF THE CEREAL INDUSTRY: THE NEED TO CHANGE NATIONAL POLICY REGARDING CONSUMER PROTECTION

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The Federal Trade Commission has recently charged that four corporations, Kellogg, General Foods, General Mills and Quaker Oats, have maintained monopoly power in the ready-to-eat cereal industry for over 30 years. The case against the cereal industry has set off a widespread wave of public reaction. Anti-business groups are anxious to prove that after all these years, America is not really dominated by big business interests after all. Consumerists are clamoring for the head of another conglomerate monster who has, so they say, been filling society's collective stomach with food products which are as expensive as they are non-nutritive. Business advocates are plaintively crying that it is high time that Americans recognized that big business is necessary both socially and economically, and that our national posture toward big business should be changed in order to protect it from periodic public witch hunting which is rooted in a system of values that became antiquated with the horse and buggy.

What are the elements of the case against the cereal industry? What is the nature of its structure and its performance and which is more appropriately the source of abuse? What is really at stake? Does the well-being of the consumer, individually and collectively, supercede the professed national desire for an industry which may or may not be appropriate today? Once the problems are identified and priorities are established, what should be the nature of the remedy? Will breaking up large corporations into smaller firms automatically insure that the consumer will be better off, or will more intelligent, consistent public scrutiny be required? The answers to the above questions should identify the central issues at stake and indicate what reasonable public action should be taken.

The Case Against the Cereal Industry

The Federal Trade Commission maintains that the four corporations cited above have illegal monopoly control over the ready-to-eat cereal industry. The four firms together control over 90% of total sales of cereals. The Commission complaint charges that this concentration of power has eliminated price competition, artificially inflated prices, raised barriers to entry into the industry, and resulted in excessively high profits. Moreover, the firms are alleged to have engaged in false and misleading advertising, to have artificially differentiated products, to have used unfair selling and distribution methods, and to have forced American consumers to pay high prices for a convenience food that is relatively low in nutritional value.

The elimination of price competition seems to be the single, most important indicator that an illegal monopoly in the cereal industry exists. Less than 50% of what the consumer pays for ready-to-eat cereal covers actual production costs. The rest of his dollar covers advertising, selling, distribution and profits.[1/] Implicit to the argument that prices are artificially high is the age-old notion that production costs are necessary and good and that advertising, selling costs and profits are relatively nonessential and wasteful when excessive. The fact that the four largest firms are able to capture 90% of the market through extensive advertising and selling techniques is objectionable not only because it constitutes a substantial barrier to entry into the industry and increases the cost of the product, but also because the firms are devoting a major proportion of operational expenses to activities that are regarded as excessively beyond the economically wholesome costs of production. Somehow Americans cannot justify that they can afford to spend 15% of their consumer dollar to convince themselves that they ought to buy a particular product in the first place.[2/]

The counter argument to the above is that today's affluent consumer is not interested in cost as much as he is in variety, convenience and status. He wants new and different products that tantalize his tired tastebuds, and he wants to be charmed into buying them. Granted, he feels somewhat guilty about the desires that accompany his affluence, but he wants them nonetheless and his buying behavior indicates it.

The private-label economy alternative to new cereal products constitutes an extremely small share of the total market for ready-to-eat cereals. While the private-label share of the market for older, more established types of products such as corn flakes can be as high as five percent, for other, newer products, the private-label industry cannot compete at all.[3/] The fact that sales of older, cheaper products

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[1/] National Commission on Food Marketing, Studies of Organization and Competition in Grocery Manufacturing, Technical Study No. 6, June 1966, p. 230.

[2/] Ibid. 15% is the proportion of the consumer dollar spent on advertising cereals.

[3/] C. R. Handy and D. I. Padberg, "A Model of Competitive Behavior in the Food Industries," AJAE, Vol. 53, No. 2, May 1971, p. 188.

are minimal indicates that today's consumer does not want a cheaper brand of corn flakes. He wants a new product altogether.

Meeting the demands of the affluent consumer requires a different orientation of a firm's activities. Instead of concerning itself with the simple process of production, the firm must anticipate demand through market research, apply the technology to develop a new product which requires large investments of capital and time, and then attempt to influence the purchase of that new product through advertising in order to protect the original investment and make a profit. Profit margins on successful products must be higher in order to cover the costs of products that fail.

The process of innovation also places different structural demands on the industry. Firms tend to be larger, and mergers become more frequent so that firms can take advantage of new opportunities as well as protect themselves through product diversification against losses due to new products that will fail. Thus, defenders of big business argue that the structure of the industry, i.e., domination of the major portion of sales by four firms, is dictated by the changing nature of consumer demand.

The argument that the structure of the cereal industry is necessary does not imply that the performance of the industry has been adequate. The problem of false advertising is particularly acute because so much advertising of breakfast cereals is directed at young children. Instead of aiming at nutrition education, advertising campaigns have led children to believe that eating pre-sweetened, low nutritional cereals will enable them to perform feats of strength that require years of healthy development and balanced diet.

Advertising aimed at adults has implied that eating certain cereals will result in weight loss, when restricting total caloric intake is necessary for weight control. Other advertisements attribute athletic performance to consumption of particular ready-to-eat cereals when in reality the product has almost nothing to do with such performance. Clearly, false and misleading advertising leads to misrepresentation of cereal products and should be regulated.

Another complaint made against advertising practices of the four cereal companies is that promotional campaigns often lead the consumer to believe that a particular product is unique and better than other similar products on the market, when actual differences are indistinguishable. Thus, product quality is the same, product differentiation is artificial, and product competition on the basis of quality does not exist.

The Federal Trade Commission also claims that Kellogg, General Mills, General Foods and Quaker Oats collaborate in distribution practices which limit the exposure of competitors' products. Kellogg provides a shelf allocation manual for retailers which recommends that those products which are purchased most frequently be allocated the greatest amount of shelf space. Insofar as such services result in a restraint of trade, they should be eliminated.

The relatively low nutritional content of ready-to-eat cereals compared to other wheat, rice and corn products is an issue that concerns many nutritionists. Professor Latham of Cornell University stated in his testimony before the Senate Subcommittee on the Consumer[4/] that the consumer pays twice as much for breakfast cereals than for other products such as bread, which supply a comparable number of nutrients. He feels that cereal firms provide convenience yet advertise nutrition. Among other things, Dr. Latham recommends that legislation be introduced which will require that cereals be fortified to at least the original nutritional content of the parent whole-grain, that food firms disclose nutrient content information on a per weight basis, and that cereal firms should be discouraged from advertising sugary breakfast cereals to children.

In conclusion, the performance of the four largest corporations engaged in the production, advertising, selling and distribution of ready-to-eat cereals has resulted in a number of seriously misleading and unfair practices. Clearly, a problem has been identified. The question that remains is what should be done about it. But before a course of action can be determined, one must have a complete understanding not only of the problems which must be corrected, but also of the public standards toward which private industry should be directed.

Directing Consumer Industry - What is Really at Stake?

Many people, especially young people, claim that affluence has turned America into a goods and pleasure factory, that the overall quality of life in America has deteriorated, and that material well-being results in the gross distortion of humanitarian and philosophical ideals. Certain individuals, especially consumerists, have identified big business as the culprit. Like the drug pusher, the argument goes, big business makes a huge profit by exploiting human weaknesses.

The cereal industry is a case in point. Nutritionists scream that cereal firms corrupt young minds by telling them that "sugar coated junkies" are good for them, and that they are undermining the American diet by promoting the sale of convenience foods which are lower in nutritional value than other cheaper, basic food commodities. To a certain extent, the cereal industry does not deserve its villainous image, for what nutritionists and consumerists alike overlook is that

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[4/] Michael C. Latham, "Breakfast Cereals--Costly Convenience, Not Better Nutrition," Testimony presented to the U.S. Senate Subcommittee on the Consumer, Committee on Commerce, August 5, 1970.

the consumer industry stays in business by producing what the consumer will buy. This is not to argue that the pre-packaged sugar coated junkie syndrome is necessarily healthy. It is simply to point out that it is not private industry's responsibility nor capacity to decide what is morally, socially and economically best for the consumer. By its very nature, the firm is limited to producing what will sell. Making industry morally and socially accountable for itself is a public responsibility and the public has shirked its responsibility for too long.

The well-being of the consumer, both individually and collectively, should be the ultimate measure of whether a consumer industry is functioning properly. "Well-being" incorporates a vast number of social, economic, moral and political variables. It can mean something as simple to policy makers as unit pricing, or it can be as complex as trying to determine whether advertising techniques have a deleterious effect on values. On the surface, determining policy to insure that industry insofar as it affects consumers, should work in their best interest, seems like a monumental, even impossible task. But there are measures which can be taken. We now turn our attention to the way in which public regulation of the cereal industry fits in, or should fit into the overall process of promoting the general welfare of consumers.

The Nature of the Remedy

The manner in which the public may exercise control over the consumer industry centers around three basic alternatives. The first of these is the traditional method of divesting assets or trust-busting. Regulatory legislation is the second. The third is the establishment of a cabinet-level department of consumer affairs.

Divestiture of Assets

Divestiture of assets is the traditional means by which society has controlled the misconduct of big business. If a firm becomes so big that it can set prices, dominate the largest share of sales, or otherwise conduct itself in a manner that is inimical to society's best interest, then the government may divest that firm of part of its assets. Breaking up a large firm into smaller firms will theoretically eliminate abusive behavior through the regulatory nature of the traditional competitive market mechanism.

As was argued previously, the oligopolistic structure of industry today is dictated by changing demand and supply conditions. Thus, public policy should encourage competition by restricting actions which restrain trade, but, as Fortune stated, it should not be government policy to prefer any particular size, shape, or number of firms to any other size, shape or number; and that mergers--horizontal, vertical, or conglomerate--are entirely legal unless they spring from a manifest attempt to restrain trade.[5]

If Kellogg, General Mills, General Foods and Quaker Oats are found guilty of deliberately restraining trade through their collective strength, then perhaps divesting them of part of their assets is a proper course of action. On the other hand, will breaking up these firms into smaller firms automatically eliminate false advertising, improve product quality, eliminate artificial differentiation, encourage better nutrition, and foster nutrition education? Obviously not. Consequently, divestiture is a rather unsatisfactory means of regulating business. Even if it is enacted, further public regulation will be necessary to improve the cereal industry's unsatisfactory performance to date.

Regulatory Legislation

The problems of affluence are relatively new to this society and the public sector has not yet learned how to deal with those problems adequately. Public censure of the consumer products industries has historically been a series of sporadic, highly emotional witch hunts, starting with the meat packing scandals around the turn of the century, the food and drug legislation of the 1930's, and the rise of consumerism in the 1960-1970's. Consequently, there remains a need for the careful and consistent scrutiny of the consumer industries.

Legislation regarding consumer industries has traditionally been a means of restriciting activities which directly threaten the health and well-being of the consumer. People accept the fact that it is a public responsibility to regulate the production and marketing of products which may be physically harmful, but are slower to accept the notion that it is a public responsibility to guide industry's activities in a direction that will lead to an improvement in the quality of life styles.

In a less complex economy where both supply and demand conditions may be determined by the traditional market mechanism, creative (as opposed to reactive) public policy cannot be afforded, nor is it required. But in a more complex, affluent society, not only can such policy be afforded, but it is also necessary if that society is to make optimum use of its resources. Thus, only in an economy in which convenience, variety, status and quality of food are more important than price per se (and in which virtually all consumers can afford the luxuries of television sets, radios, magazines, etc.), do issues such as honesty in advertising, public education and product quality become important to public policy makers.

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[5] "A Fortune Proposition," Fortune Magazine, March 1966, p. 129.

To restate this hypothesis, the new capacities and demands which accompany affluence make public policy obsolete which is designed to react only when certain cases of physical abuse occur. In the first place, due to research and technology, a firm is far less likely to market a product which is potentially harmful since such defects are usually discovered before a product is marketed. In the second place, the ways in which a consumer is affected by a firm's activities is infinitely more complex and subtle today than it was 50 years ago. It is much more difficult to determine whether advertising benefits consumers both publicly and privately than it is to determine whether a certain hair dye causes blindness, but both issues may be equally important.

Regulatory legislation is one means by which industry's activities may be guided in the interest of promoting the general welfare. In the case of the cereal industry, legislation defining a stricter national policy toward marketing and distribution practices, especially advertising, could eliminate unfair, misleading and otherwise unacceptable practices. Stricter controls should be enacted to identify and prevent dishonesty in advertising. Firms should be required to provide more information as to nutritional content and product quality. Perhaps excessive advertising costs should be taxed to discourage high prices for the consumer.

Public education is also an important issue relating to advertising. Apart from the obvious problem of false or misleading advertising, exposing people, especially children, to a set of commercial ideas aimed at encouraging a particular form of buying behavior has a definite impact on both public and private values. Public policy should establish that air waves and television time are public property insofar as they affect public welfare, and that if a firm wishes to use them as a vehicle to promote the sale of a product, then it must also provide in its advertising a certain amount of educational material and information useful to the public. In food industries, this could work to increase nutrition education as well as promote the sale of particular products.

A Department of Consumer Affairs

The previous discussion has established that the needs and interests of affluent consumers in a complex economy are vastly different from the needs of less affluent consumers in a more traditional economy. Emotional crusades based on obvious, isolated cases of industrial malfunctioning can no longer assure that the needs of consumers today will be adequately and consistently met by industry. While they have their place, such crusades may even detract from consumer interests in that people rapidly grow bored with the hysteria that crusaders are, by their very nature, limited to creating.

Consequently, there remains a need for the intelligent and consistent analysis of consumer affairs and demands. Efforts aimed at studying, guiding and generating public policy will require a reservoir of expertise and data that currently does not exist. Being able to recognize and act upon cases of blindness caused by hair dyes, for example, requires no additional staff or organization. But assimilating education into advertising will.

For the above reasons, the institutionalization of a cabinet-level department of consumer affairs seems to be the best means of deciding national policy to protect what is perhaps the only majority interest group in the country. Let us not punish the cereal industry for its sins by breaking up its largest corporations into smaller firms, and consider the job done. Let us, rather, recognize that public policy in the area of consumer affairs is woefully deficient and take steps to alleviate that deficiency.

Summary and Conclusions

The performance of the four largest firms engaged in the production of ready-to-eat cereals has resulted in a number of seriously misleading and unfair practices. The firms have engaged in false advertising, they have sometimes artificially differentiated products, thus limiting product competition, and they have provided distribution services for retailers which have restricted the exposure of competitors' products. Moreover, consumption of these cereal products does not result in better nutrition, nor do advertising campaigns result in better public nutrition education.

The case against the cereal industry has the following implications for public policy regarding consumer protection. First, consumer satisfaction is no longer a matter of providing traditional products as cheaply as possible. Consumer interests today incorporate things such as product quality and progress as well as environmental protection and public education.

Second, given that the needs of affluent consumers are significantly different than they once were, there is also a need for new public policy in the area of consumer affairs. Finally, the suggested means of closing the gap between consumer interests and industrial performance are (1) regulatory legislation and (2) the institutionalization of a cabinet-level department of consumer affairs.

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