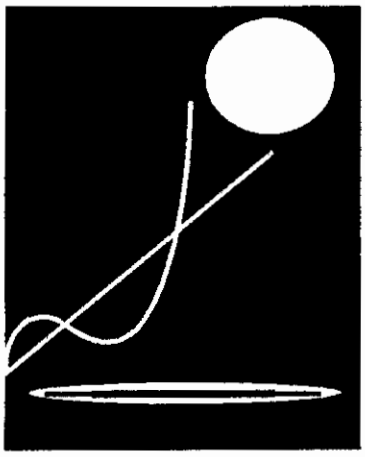

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High Cereal Prices and the Prospects for Relief by Expansion of Private Label and Antitrust Enforcement

by

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University of Connecticut

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HIGH CEREAL PRICES AND THE PROSPECTS FOR RELIEF BY EXPANSION OF PRIVATE LABEL AND ANTITRUST ENFORCEMENT

by Ronald W. Cotterill[*]

EXECUTIVE SUMMARY

- a bowl of breakfast cereal with milk does not, as the industry claims, cost 25 to 30 cents. When 22 leading brands are checked, a bowl of cereal with milk costs an average 81 cents and ranges from a low of 48.4 cents (Kelloggs Corn Flakes) to a high of $1.14 (Post Banana Nut Crunch).

- cereal is not, as the industry claims, a good value. The price of Certified Black Angus sirloin steak at $2.89 lb. is cheaper than 19 of the 22 cereals price checked. A steak and egg breakfast is cheaper than many bowls of breakfast cereals. High cereal prices are due to high levels of advertising, other nonprice marketing add ons, and high profits.

- contrary to the industries claims, coupon use by consumers, does not offset the increases in announced cereal prices between 1983 and 1995 or between 1989 and 1993. In both periods the price consumers paid, net of coupons, increased more rapidly than the food at home component of the Consumer Price Index. Prices of breakfast cereal, net of coupons increased between 17 and 24 percent from 1989 to 1993 when the Food at Home CPI increased 12.6 percent. The industry's claim of 6.6 percent net of coupon cereal price increase during this period is based upon as faulty projection of a sample result to the entire U.S. population.

- the cereal industries claim that the judges opinion in a recent New York court case establishes that the industry is intensively competitive. A careful reading of the opinion in State of N.Y. v. Phillip Morris et al. however reveals that the judge did not deny that this industry competes in a costly nonprice fashion. She concluded that this preference for nonprice competition in lieu of price competition is not due to collusion, rather is the result of independent actions by the leading firms. Yet Wall Street analysists and many economists have documented that the independent action of firms in this industry are a form of tacit collusion that produces the observed poor (from the standpoint of consumers and grain farmers) performance record.

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- unilateral market power is the ability of a firm to elevate the price of a brand of breakfast cereal above its cost of production because they have differentiated the product through advertising and positioning in a segmented cereal market. In the N.Y. case the judge ruled that combining Nabisco Shredded Wheat with the Post cereal operations, most notably its marketing of Post Grape Nuts, would not allow Post to increase the price of these breakfast cereals. Even if this is correct it says nothing about the exercise of unilateral market power among other brands in the portfolios of the big four cereal companies, Kellogg, General Mills, Post and Quaker.

- the industry claims that my numbers and economic analysis have been presented to the FTC and Antitrust Division of the Justice Department and that these agencies have rejected the analysis that I presented as expert economist for the state of N.Y. in their recent unsuccessful challenge of the acquisition of Nabisco Shredded Wheat by Phillip Morris. In fact all exhibits and analyses presented at this public trial remain unavailable to the public, including federal agency staff, because Phillip Morris is disputing their release. Their argument is that release of many documents would provide sensitive information to their competitors. But the great majority of these documents are for economic activities in the early 1990's that are of no competitive significance today. Phillip Morris does not want the public to learn how this industry operates. Consumers Union is intervening in the court proceedings on behalf of consumers to argue for keeping public trial records public.

- private label breakfast cereals provide consumers real value, and their continued expansion will improve the price performance of this industry. Branded manufacturers, however, prefer to compete with private label by further segmentation of the market because private label can't achieve sufficient distribution volume needed for economic viability when copying small share brands.

- the long run success of private label will depend upon major changes in marketing strategies and management structure at leading supermarket retailers. British supermarket retailers and mass merchandisers such as Wal-Mart have demonstrated that the needed changes can be achieved and that they are profitable. These changes will lower prices to consumers due to more efficient distribution, less advertising and nonprice marketing activities.

High Cereal Prices and the Prospects for Relief by Expansion of Private Label and Antitrust Enforcement.

Congressmen Gejdenson and Schumer should be commended for their persistent interest in the performance of the ready to eat cereal industry. The release of their well documented and thorough report, "Consumers in a Box" a year ago focused media attention on high cereal prices, which in turn documented widespread consumer anger over this industry's performance. Today, the Congressmen have asked for an assessment of the factors that contribute to high cereal prices, and the outlook for consumer relief from the expansion of private label cereals, and more effective antitrust enforcement.

This is no small task. I would like to begin by responding to the industry's rebuttal to the Congressmen's report. None of the cereal manufacturers has commented publicly on the Congressional inquiry. Instead, they have designated Mr. Jeffrey Nedelman of the Grocery Manufacturers of America as their common spokesman. The GMA's entire written response consists of a three page press release that contains seven "facts". The fact sheet is reproduced in the appendix.

Fact #1 is the cheap breakfast defense. The GMA states "Breakfast Cereal provides consumers with real value. Today the average bowl of ready to eat cereal, including milk, costs between 25 and 30 cents." To see whether this is true, I did what any consumer can do. I went to a large regional chain supermarket where I buy groceries and collected prices on 22 leading cereal brands. My results are reported in Table 1. I chose box sizes that I would buy for my family of four (not the smallest ones). First I computed the price per serving. Then I noticed that a serving is not a bowl of cereal. Quaker Puffed Wheat, for example, claims 1/2 ounce (15

grams) is a serving. Most use 1 cup; however, this is only a half bowl of cereal. I computed a bowl price by using 2 cups of cereal or at a minimum 60 grams of cereal. These bowl prices are reported in the next to last column of Table 1. Adding one cup of skim milk produces the cereal with milk prices that are in the last column. This column is in bold print because this is the price a consumer pays for a bowl of cereal for breakfast. The average bowl price is 81 cents and ranges from a low of 48 cents to $1.14. Figure 1 displays the frequency distribution of the prices. The 25-30 cent cereal breakfast is a myth. It is incredible that the industry leads its rebuttal argument with such a disingenuous use of nutrition labels.

To see what the costs of other breakfast options are, I collected prices on Cinnamon Raisin bagels, large grade A eggs, Certified Black Angus sirloin steak, and World Classics Stone Ground Whole Wheat Bread. These are reported in Table 2. Note that the sirloin steak @ 2.89/lb. is cheaper than 19 of these 22 breakfast cereals. The nutrition labels for three of the cereals, the bagels and bread are provided in the appendix. One slice of this bread is equivalent to a serving of cereal within the USDA guidelines and costs only 8.4 cents. In fact, I can eat a breakfast with steak (2 oz.), an egg, two pieces of toast and coffee for 73 cents. Breakfast with a 1/4 lb. of steak costs $1.09. These compare favorably to many of these bowls of cereal. (For another 18 cents I would add an 8 oz. glass of orange juice to either option). Cereal is not a "good value."

Professor Frederic M. Scherer gives the economist perspective on "good value" in the cereal industry writing:

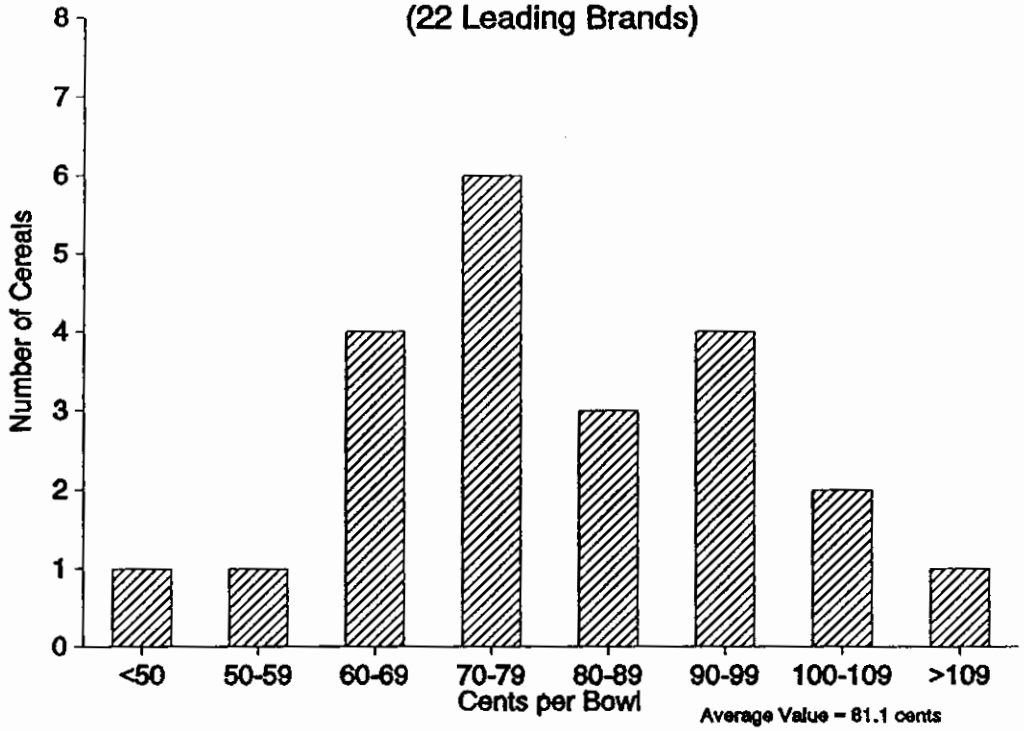
> "OPEC claimed that their cartel was innocuous because the cost of their energy source was still much less than other alternatives. The true question is what would the price of cereal be under a purely free enterprise situation. Nature endowed cereal makers with an unusually economical means of providing

Table 1. Cost of Selected Brands of Cereal per Serving and per Bowl (22 leading brands).

Brand	Box Size[1]	Price	Price per lb.	Serving Size[1]	Price per Serving	Price p.s. w/Milk[2]	Price per Bowl[3]	Price/Bowl w/Milk[4]
K Corn Flakes	18/510	2.69	2.39	1cup, 1.1/30	15.8	24.2	31.6	**48.4**
K Frosted Flakes	20/567	4.39	3.51	.75cup, 1.1/30	23.2	31.6	62.3	**79.0**
K Rice Krispies	15/425	3.49	3.72	1.25cup, 1.1/30	24.6	33.0	49.2	**66.0**
K Complete Bran Flakes	17.3/490	3.59	3.32	.75cup, 1.1/30	22.0	30.4	58.5	**75.3**
K Raisin Bran	25.5/722	4.99	3.13	1cup, 2/55	38.1	46.5	72.2	**93.0**
K Frosted Mini Wheats	19/539	4.29	3.61	1cup, 2/55	43.7	52.2	87.4	**104.4**
K Apple Jacks	15/425	4.29	4.58	1cup, 1.1/30	30.3	38.7	60.6	**77.4**
K Fruit Loops	11/312	3.29	4.79	1cup, 1.1/30	31.6	40.0	63.2	**80.0**
K Pop Tarts	12.5/354	3.89	4.98	.75cup, 1.1/30	33.0	41.4	66.0	**82.8**
GM Cheerios	20/567	4.35	3.48	1cup, 1.1/30	23.0	31.4	46.0	**62.8**
GM Wheaties	18/510	3.56	3.16	1cup, 1.1/30	20.9	29.3	41.8	**58.6**
GM Total	18/510	4.35	3.87	.75cup, 1.1/30	25.6	34.0	51.2	**68.0**
GM Kix	13/368	3.49	4.30	1.33cup, 1.1/30	28.5	36.9	57.0	**73.8**
GM Trix	17/481	4.69	4.41	1cup, 1.1/30	29.3	37.7	58.6	**75.4**
GM Count Chocula	12/340	4.29	5.72	1cup, 1.1/30	37.9	46.3	75.8	**92.6**
P Raisin Bran	20/567	3.49	2.79	1cup, 2.2/59	36.3	44.7	72.6	**89.4**
P Banana nut Crunch	20.5/581	4.79	3.74	1cup, 2.2/59	48.7	57.1	97.4	**114.2**
Post Fruit and Fiber	15/425	3.79	4.04	1cup, 2/51	45.5	53.9	91.0	**107.8**
P/Nab S.S. Shredded Wheat	17.2/487	3.89	3.62	1cup, 2/49	39.1	47.5	78.2	**95.0**
Q Puffed Wheat	6/170	2.29	6.11	1.25cup, .55/15	20.3	28.4	81.1	**97.9**
Q Captain Crunch	16/453	3.62	3.62	.75cup, 1.0/27	21.6	30.0	57.5	**74.3**
Q Life	21.7/615	3.79	2.79	.75cup, 1.1/32	19.6	28.0	52.1	**68.9**
Average Value					29.9	38.3	64.2	**81.1**

[1] Weight in ounces and grams.
[2] 1/2 cup skim milk @ 2.69/gal.= 8.4 cents.
[3] This is 2 cups or at minimum 2.2 oz. (60 grams) of cereal.
[4] 1 cup skim milk @ 2.69/gal.= 16.8 cents.
Source: Food Marketing Policy Center, University of Connecticut.

Figure 1. Frequency Distribution of Cereal Cost per Bowl with Milk (22 Leading Brands)



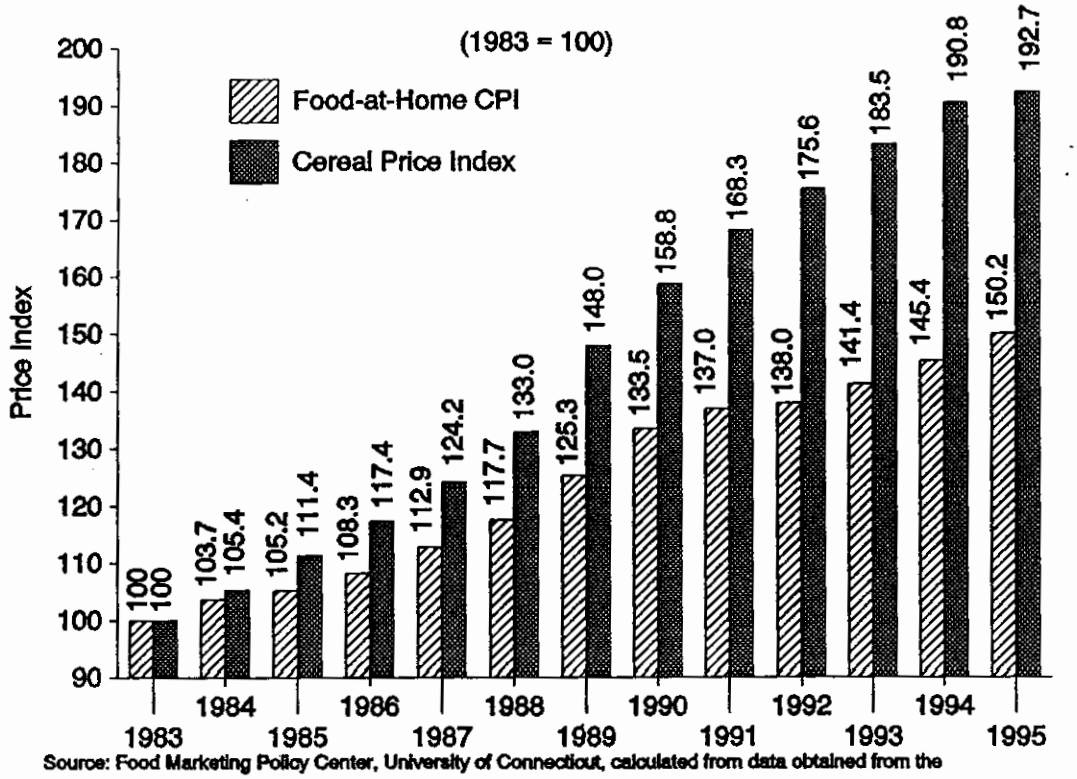
Source: Food Marketing Policy Center, University of Connecticut

Table 2. Costs of Other Foods.

Name	Size[1]	Price	Price per Pound	Serving Size[1]	Price per Serving
World Classics Stone Ground 100% Whole Wheat Bread	24/680	1.59	1.16	1 Slice, 1.3/35.8	8.4
Big Y Cinnamon Raisin Bagels	24/680	1.69	1.13	1 Bagel, 4/113	28.1
Large, Grade A Eggs	Dozen	1.19	-	1 Egg	10.8
Boneless Sirloin Steak	-	-	2.89	2 oz.	36.2
Taster's Choice Instant Coffee	7/198	7.39	16.89	1 teaspoon	9.2
Big Y Frozen Orange Juice Concentrate	12 oz.	1.09	-	8 oz. mixed	18.2

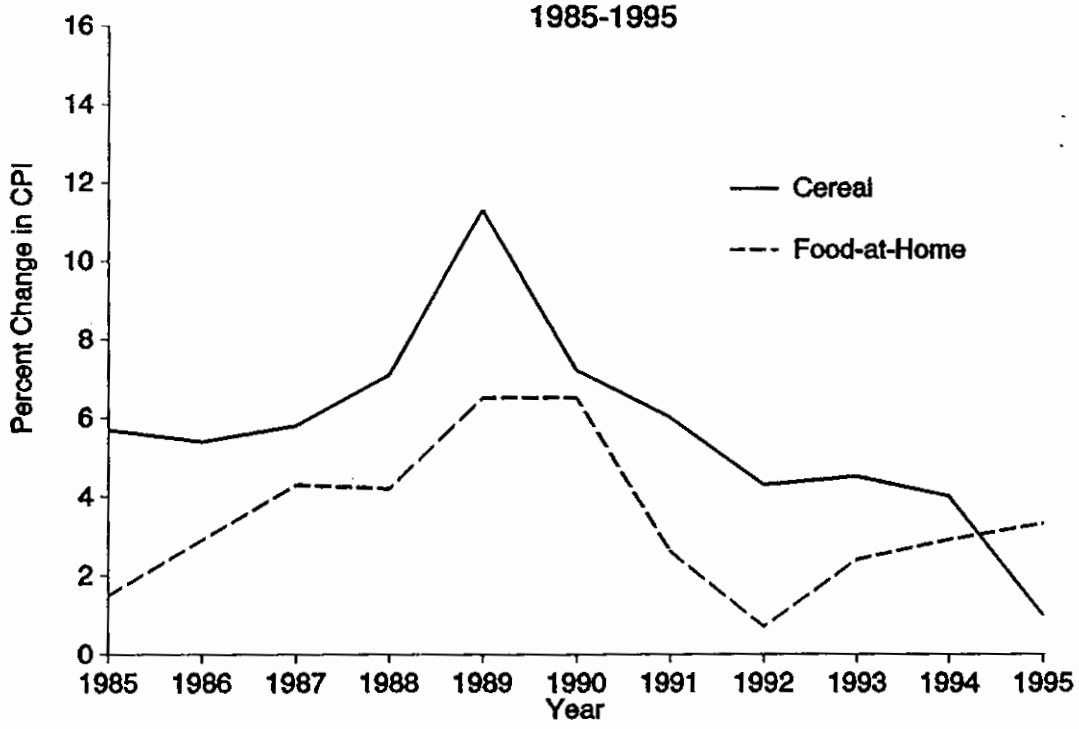
[1] Weight in ounces and grams.
Source: Food Marketing Policy Center, University of Connecticut.

Figure 2. RTE Cereal Price Index vs Food-at-Home CPI



Source: Food Marketing Policy Center, University of Connecticut, calculated from data obtained from the Bureau of Labor Statistics, U.S. Dept. of Labor, Washington, D.C. 20212

Figure 3. Annual Percent Change in BLS Cereal and Food-at-Home Prices, . 1985-1995



Source: Food Marketing Policy Center, University of Connecticut, compiled from Bureau of Labor Statistics, U.S. Dept. of Labor.

nutrition. If they have abused that endowment by pricing above a competitive level they have performed badly." {Gailbraith, p. 31}

Fact Number 2, and I quote, is "Cereal Prices in real terms have risen less than the rate of inflation--between one and two percent annually." This is the "consumers don't know what they are talking about, the prices of breakfast haven't gone up as fast at other foods," defense. Figure 2 graphs the Bureau of Labor Statistics cereal price and the food-at- home price indices over the twelve years. Until 1995, cereal price advances regularly dominated food at home advances. Between 1983 and 1994 cereal prices increased 90.8 percent whereas all food prices increased 45.4 percent. Figure 3 graphs the per cent change for each year. Last year was the first time that announced cereal price increases were less than all food price increases. The Congressmen's focus of attention on this issue and the ensuing media stories including segments on *ABC Good Morning America, ABC 20-20, NBC Today, NBC Phil Donahue, NBC, Ch. 4 Washington, D.C., and CNBC* have had an impact. For the first year since who knows when Kelloggs and Post did not announce price increases in 1995. Others announced only modest price increases.

This industry's claim that the government statistics are misleading is based upon the fact that they are not adjusted for coupon use by consumers. This point doesn't exonerate the industry. In fact during 1994 and 1995 it is well documented that reductions in consumer oriented price give back programs contributed to an increase in the actual net price consumers paid even though in some instances shelf prices went down.

The GMA however focuses upon an earlier era. They assert that ready-to-eat cereal prices, net of coupons redeemed by consumers, increased 6.6 percent between 1989 and 1993. They compare this to an accurately calculated increase in the food-at-home consumer price index

of 12.8 percent over this period and an overall consumer price index for all items of 16.5 percent.

Let's examine this relationship between the increase in cereal prices and the food-at-home component of the consumer price index for the 1989 to 1993 period in more detail. Figure 2 indicates that the food-at-home CPI increased from 125.3 in 1989 to 141.4 in 1993. This 16.1 point increase is a 12.8 percent increase. The BLS cereal index in Figure 1 increases from 148.0 to 183.5. This 35.5 point increase is a 24 percent increase in the price of breakfast cereal. The cereal industry would have us believe that once one has adjusted for coupons that consumers redeem, this 24 percent increase would be reduced to 6.6 percent.

Yet the Congressmen's study reports that in 1993 Americans redeemed only 2 percent of the coupons that the industry distributed. These 500 million coupons had an average face value of 88 cents, which means that consumers received $440 million in benefits from coupon redemptions. There are two sources for this estimation of couponing activity in the industry. One is CS First Boston which is the cited in the "Consumers in a Box" report and a second source is General Mills which is cited in the Congressional Research Service Memorandum on Cereal Pricing dated December 23, 1994. Since industry sales in 1993 were $8.27 billion, the $440 million reduction constitutes a 5 percent reduction in price. Using this fact, if one reduces the BLS cereal price index value of 183.5 in 1993 by five percent, one obtains a net of coupon index value of 174.3. Comparing this to the 1989 value of 148 one has an increase in the net of coupon price of 26.3 points. This is a 17.8 percent increase in the net of coupon price. But this estimate is clearly biased down from the true net of coupon price increase because coupons are not netted out of the 1989 price index. (We do not have coupon information for 1989).

Adjusting the 1989 price index down for the coupons used during that year would increase the absolute and percent change for the 1989-1993 period.

If coupons reduced prices 5 percent in 1989, then the percent change in the net of coupon price is 24 percent, the same as the percent change in the CPI price. If the coupon related reduction in price in 1989 is less than the five percent reduction in 1993, then the percent change in net of coupon price between 1989 and 1993 is less than 24 percent, but above the 17.4 percent value that assumes no coupon usage in 1989. Since millions of coupons were redeemed in 1989, the percent change in the net of coupon price between 1989 and 1993 is above 17.4 and most likely very close to 24 percent. This estimate is triple the GMA estimate.

The erroneous GMA 6.6 percent net of coupon price increase is from a recent antitrust suit (State of New York v. Phillip Morris, Kraft/General Foods, Southern District Court of New York). I served as expert economist for the State of N.Y. and am very familiar with the facts and decision in that case. If one goes to the public trial record, one will find that at the time this estimate was introduced to the court by Phillip Morris, the State of New York rebutted it with business records from the companies that were not generated for purposes of litigation, as was this particular A.C. Nielsen estimate.

Specifically, the 6.6 percent net of coupon price increase is based upon a Nielsen household panel sample of consumers that does not provide an accurate estimate of all consumer's behavior in the market place. At trial, the State of New York showed that this particular Nielsen sample significantly overestimates coupon redemption rates by the general public. For example, Post's own business documents indicate that it redeemed $75 million of coupons in 1992 but the overstated Nielsen sample redemption rate erroneously predicts that Post

redeemed $175 million of coupons in 1992 (State of New York v. Phillip Morris, Kraft/General Food, Trial Transcript @ 2227-2234). Judge Wood offered Kraft extra time, if needed, to rebut the State of New York (Transcript @ 2227) and Kraft did not respond. Use of this flawed document with its dramatic over-estimation of consumer benefits due to coupon redemption is self serving for the industry. Consumers are not wrong when they complain about cereal prices that they judge in their neighborhood supermarkets to be high.

Since cereal is no "cheaper" than steak and eggs for breakfast and BLS prices have risen dramatically over the past 12 years but for the recent slowdown, it is entirely appropriate to ask why have the prices consumers pay gone up so much? Again, according to the GMA fact sheet and the cereal manufacturers, this is not due to the domination of the industry by three firms, high barriers to entry and noncompetitive price conduct as documented by several reports during the past 15 years (Scherer, Shepherd, Sutton, Gailbraith, Mauboussin, Gejdenson and Schumer, Kahn). The cereal manufacturers maintain that their industry is intensely competitive and has become more so over time (GMA Facts 3 and 4).

Herein lies a fundamental confusion around what is meant by the term competitive. Businessmen claim they compete when they advertise, issue coupons in a fashion that allows price discrimination, and devote massive resources to product proliferation that creates barriers to entry and elevates the prices of all cereals. When economists and the antitrust authorities measure competition they focus first and foremost upon price (Federal Merger Guidelines, p. 20-25). Competitive industries price at or near marginal cost. Firms in such an industry do not have power individually or collectively to elevate price above cost levels. As the Gejdenson and Schumer report document prices in this industry are significantly above the cost of production.

Appendix Table A-4 provides a breakdown of retail and manufacturer prices. A significant portion, 55 percent of the manufacturer price goes to marketing and promotion expenses and profits. These are not cost of production expenses.

Permit me to quote, not from academics since they are out of favor with this industry, but two recent Wall Street studies to illustrate why this industry can generate the highest Bureau of Census computed price cost margins of any food industry and the fourth highest in the U.S. economy (Gejdenson and Schumer, p. 6). Wall Street's message is 1) the oligopolistic consensus in this industry is strong, barriers to entry are higher than ever, and 2) investors need not fear a "Marlboro Friday" price war as occurred in cigarettes in early 1994. Noncompetitive pricing, cash flows and high long term profits make the long term outlook for this industry extremely attractive. Steve Gailbraith, a Bernstein Research analyst writes:

> "In looking at the overall food industry today it is clear that there is a close correlation between Herfindahl indices (of seller concentration) and industry profitability levels. While the R-T-E industry does not enjoy the levels of concentration of the domestic soup or the baby food industry, we believe the category is sufficiently concentrated to ensure that the 80-year history of above-average returns on capital is more likely than not to persist. ..."
>
> "In light of the extremely attractive long-term outlook for the domestic cereal industry's profitability, many investors continue to express concerns that additional entrants will be enticed to join the category, putting further pressure on industry profitability. Historically, however, entry into the category has proved difficult at best, and only low-end producers have been able to gain share in recent years (and, in fact, almost all the low-end share gain has come at the expense of Ralcorp's branded business--the change in other industry participants' share has been minimal). Some very powerful food companies have tried--and failed--to join the industry in the past. We believe that the economics and risk of entry at the branded end of the business have, if anything, become *more* daunting for the new entrant; we view it as extremely doubtful that there will be any significant new participants in the branded end of the category.
>
> In our view, the industry has reached such a profound level of market segmentation that a new branded entrant would probably have to produce as many

as *six* successful brands in order to have sufficient mass to remain a viable long-term player in the industry. Industrial studies have indicated that real efficiencies of scale for a plant kick in at about the 80-million pound level (about a 3% tonnage share base). At this level of capacity, a new plant could achieve sufficient economies of scale to support profitably the cost of capital required to enter the industry at the branded end. Historically, especially in the '50s and '60s, such a level of market share could actually be achieved through the introduction of one or two winning formulae (Frosted Flakes introduced in 1953 achieved almost a 4% share in two years, Cap'n Crunch entered the industry in 1965 and quickly achieved close to a 3% share). In the past, a wholly new industry participant and existing players would actually have been on reasonably equal footing. Today, however, existing industry players can profitably support a new product with market share as low as 30-50 basis points--this is because established producers typically only have to make marginal capital investments to support new product roll-outs. We believe the likelihood of a *new* branded entrant achieving mass (of 3% market share) in any short period of time is extremely small. In fact, no established participant has done so in any five-year period in recent history (although General Mills came close with some of its Cheerio flankers in the 1980s--Honey Nut Cheerios, for example, now has about a 2.5% share)." [Gailbraith, pgs. 31-35].

Academic studies also document that high seller concentration, especially in food industries, does result in persistently high profit rates (Connor, Cotterill and Iton, Mueller, Kwoka and Ravnscraft). They also establish that barriers to entry are so high in cereal that the discipline of potential competition does not exist (Sutton, Schmalensee). Thus consumers must rely upon rivalry among established firms to produce competitive prices. This, in fact, does not occur.

Michael Mauboussin, a CS First Boston Analyst, explains that price interdependence leads firms to price in a noncompetitive fashion. Others including Gailbraith and many academics concur. Although this industry does not explicitly collude by assembling as OPEC does in meetings to fix price, tacit collusion does occur in the market place. Mr. Mauboussin maintains that the industry follows a "tit for tat" strategy that results in a joint profit maximizing (high price and high price cost margin) equilibrium. He writes:

"It is our view that Kellogg's competitive strategy in the U.S. ready-to-eat cereal business mirrors a tit-for-tat strategy closely. Over the years, Kellogg has been a good leader, pricing its products and spending its marketing dollars responsibly. In so doing, it has provided the industry near-maximum profits (starts by cooperating). In the early 1990s, due to a number of circumstances, General Mills appeared to take more of a "defection" stance which, for a few years, paid off. Kellogg responded to General Mills' "defection" by "defecting" itself, thus lowering profits for both players (defects swiftly and decisively).

In April 1994, General Mills clearly shifted its strategy to one that can be fairly termed as "cooperation." By lowering prices and reducing promotional spending a greater amount, General Mills demonstrated concern not only about its own profit outlook, but about the profits of the industry. Consistent with a tit-for-tat strategy, Kellogg also reduced promotional spending and is not likely to increase prices in the near term as it has over the past two years (forgives). This most recent strategy shift has led to increased profitability for Kellogg, prompting the company's CEO to declare that the economics of Kellogg's U.S. cereal business are "terrific.". . .

Our analysis has dwelled on only two industry participants--albeit they represent the majority of the business--and has excluded three other companies. Our most basic rationale for this is that we are unconvinced that any of these three companies (Post, Quaker Oats, Ralcorp) would be able to permanently affect the industry structure. This is so because either Kellogg or General Mills is in a position to exert substantial profit pressure on any of these companies, and would likely do so if the smaller company pursued strategies that were detrimental to the category." [Mauboussin, p. 4.]

If this is not a description of tacit collusion then what is it? Judge Wood discusses this very same observed pattern of conduct in the cereal industry. She writes:

"Manufacturers of RTE cereal, with minor but growing exceptions, compete largely through new product introductions, advertising, couponing and trade allowances. The State is critical of these forms of competition, claiming, among other things, that they are wasteful and inefficient means of delivering products to consumers, that they erect barriers to new entrants, and that they are used to the exclusion of price competition in the form of "everyday low prices." Professor Kahn was also critical of the ways in which participants in this industry compete. Tr. at 2378-2379 (Kahn). The State contends that competition has been limited to these forms as a result of "collusion" among the large manufacturers. The State produced no evidence of explicit collusion, and appears to rely heavily on evidence that the two manufacturers with the largest market shares are "leaders" in taking price-related actions, that other manufacturers generally follow

> the "leaders," and that all of the manufacturers act with a recognition of their interdependence, which causes them to avoid the price-depressing practice of selling at "everyday low prices," and causes them instead to rely almost exclusively on the other forms of competition noted above. The record does not support plaintiff's contention that the forms competition has taken in the RTE cereal industry result from collusion rather than from independently determined conduct." {70 F. Supp. 911}.

Two very important insights emerge from this passage. First note that the Judge does not deny the wasteful nonprice conduct of this industry. This case does not provide a "seal of approval" for the conduct of this industry, as claimed by the GMA Fact Sheet. Second, she asks whether the observed conduct is due to "collusion" and concludes that it is not. She maintains that it is due to independently determined conduct. But what this describes as independently determined conduct is the very core, as Mauboissin explains, of tacit collusion that allows the firms to elevate prices. These high prices establish a noncompetitive margin between price and direct production cost which in turn is used for anticompetitive levels of marketing and profits. In other words establishing that conduct in the market place is "independent" does not prove that there is no tacit collusion. Edward Chamberlin, writing in the 1930's first explained that firms acting independently to maximize their own profits, can, by following relatively simple rules of conduct such as price leadership, move the industry price level to the monopoly level (Scherer and Ross, p. 205).

The judge also found that unilateral effects, profit seeking actions by a single company that do not need a cooperative response by another company, were not materially enhanced in this merger case. Post's acquisition of the Nabisco Shredded Wheat line did not, in her opinion allow the company to elevate the price of Grape Nuts and Shredded Wheat, two close substitutes, ostensibly because of competition with other brands of breakfast cereal. Again,

(even if it is correct) this conclusion does not extend to all brands in the industry. It is entirely possible and quite plausible that the concentration of most brands into the portfolios of the big three cereal companies gives each of them unilateral pricing power.

The industry would also have us believe that it has become more competitive since one measure of seller concentration, the Hirschman Herfindahl Index (HHI) which is the sum of the squared market shares of all firms in the industry, has declined by 25 percent since 1970 (from 2755 to 2215 in 1992). This argument implicitly recognizes the importance of high seller concentration for effective tacit collusion. The HHI has declined because Kellogg has lost share primarily to General Mills over this period; however, this shift has not lowered the HHI to a level where research (as documented above) and anti-trust agency staff automatically view this industry as effectively competitive. At 2215 the HHI is not below the 1000 level where mergers are routinely approved. It remains about the 1800 level where the merger guidelines state "the agency regards markets in this region to be highly concentrated. . .Where the post merger HHI exceeds 1800, it will be presumed that mergers producing an increase in the HHI of more than 100 points are likely to create or enhance market power or facilitate its exercise. [Guidelines p. 16]. If the proposed merger increases the HHI by less than 100 points, as the Judge decided in this case, there are similar concerns but one must look at the conduct of the industry to determine competitive impact.

The industry through the GMA argues that the views of, and I quote, "the nutty professor from Connecticut" are without merit because I served as expert economist for the State of New York and the judge ruled against the state. According to Mr. Nedelman, the analysis and

"numbers" that I presented to the court have also been presented to and rejected by staff at the F.T.C. and Department of Justice as well.

Although the judge's decision was issued over a year ago, and the transcript of the trial is public, a full public review and discussion of that case is not possible because all of the exhibits in the trial, including statistical analyses, reports, tables and charts by plaintiff's and defendant's economists and relevant documents from the business records of the firms have yet to be made public. No one, including the staff at the Justice Department on the FTC has seen the "numbers" and economic analyses that were presented at trial. In fact the analysis done for the State of New York squares precisely with recent statements by Carl Shapiro, Deputy Assistant Attorney General, Antitrust Division of the Justice Department, and by Jonathan B. Baker, Director, Bureau of Economics, F.T.C. on how to analyze the impacts of a merger in a differentiated industry such as breakfast cereal. Each mentions the N.Y. case.

I look forward to the time when I can present and discuss the analysis, but Phillip Morris and others in the industry do not have a similar feeling. The release of the trial exhibits in this case is tardy and in dispute. The trial was public and the public has right to know in complete detail the facts and arguments that were presented. This is especially true in this case because the judge used verbatim, the defandants Proposed Finding of Fact for all of her written opinion except the findings of law section. Not one disputed fact in the Kraft General Foods brief, and there were many, was decided in favor of the state.

Kraft General Foods seeks to restrict the public's access to the facts in this case on the grounds that it would damage competition because their competitors would receive information on their internal operations. The trial in this case was in Sept. 1994. There are very few facts

from the pre September 1994 era that have competitive relevance today. Moreover the big three firms in this industry already know what each other is doing with a great deal of precision (Cotterill 1996). The industry wants this record put under seal so that the public cannot more fully understand their operations and the decision in this case. For example my first affidavit in this case in January 1993 was made public before Kraft General Foods attorneys came up to speed. It contains two profit rates. Nabisco Shredded Wheat operating profit jumped to 29 cents of every dollar sold in 1990 when RJR/Nabisco decided to harvest it's ready to eat cereal business by raising prices and slashing consumer promotion and advertising. This was a component of their drive to raise cash to pay for the record 28 billion dollar leveraged buyout that capped the merger mania of the 1980s (Barbarians at the Gate). Post also increased price and reduced marketing so that 33 cents of every dollar they received for Grape Nuts in 1990 was operating profit. These rates are well above the industry average profit sales rate of 17 percent which is very high by food industry standards. The record on this case contains similar profit rates for these brands for 1991, 1992, 1993 and year to date 1994. Since Post acquired Nabisco Shredded Wheat in Jan. 1993 two of these monitor profitability after the merger. Kraft General Foods does not want the public to know those profit rates. They do not want the public to know how many millions of dollars consumers paid into their corporate coffers for these two cereal brands that accounted for less than five percent of the total cereal market. I estimate their 1990 profits to be $91.5 million (profit rates time 1990 sales estimates from the University of Connecticut, IRI data base) multiplying $91.5 million times 5 give $457.5 million operating profit for the 1990-94 sales of Grape Nuts and Shredded Wheat. This demonstrates the level of market power corporations can garner in "quiet corners" of this market.

Attorney's working pro bono on behalf of the Consumers Union are intervening in the Court proceeding to argue for full public disclosure. The industry cites this case as evidence that it is competitive. For their argument to be credible they can not now move to seal the record in this public trial. Let the public see all the facts.

This leads squarely to one of the other topic areas that the Congressmen requested information on, the prospect for consumer relief via antitrust enforcement. As the New York case indicates, it is very difficult to challenge successfully this industry in court under the Sherman and Clayton antitrust acts. Even when there is widespread consensus among academic economists, government lawyers and Wall Street analysts on how this industry operates in noncompetitive fashion and even when consumers clearly are angry about the performance of the industry, courts support this industry and find that it does not violate the antitrust laws.

The New York case is also controversial from the standpoint of law because it suggests that tacit collusion on price behind high barriers to entry in a concentrated market is not sufficient to establish that the industry is exercising market power. If the Judge had so ruled then the burden of proof shifts to the defendant who must demonstrate that the proposed merger would enhance competition or result in efficiency gains that lower consumer prices for brands of breakfast cereals. The New York ruling implys that as long as the firms are competing in some way, for example by back of the box offers of free toys, the industry is competitive. This is the businessman's, not the antitrust economist's, definition of competition. Inserting the businessmen's definition into the antitrust laws means that no merger, not even a merger between Coke and Pepsi or General Motors and Ford, absent explicit documented collusion (price fixing), would be anticompetitive. And if one can document that the industry is violating

results in fines and/or jail sentences for the executives involved. This is not the way Congress intended merger enforcement to extend the reach of the antitrust laws.

Professor Alfred Kahn, the court's economist in this case presented a similar viewpoint after listening to the three week trial. He recognized the performance of the industry from the standpoint of price and consumer's desire for low prices was poor but recognized that they did compete in other ways (transcript p. 2367, 2372). He concluded, however, that the Post-Nabisco merger made no difference and, therefore, did not tend to significantly lessen competition (transcript p. 2378-79). In my opinion, this reasoning fails to recognize the shift in burden of proof once anticompetitive price conduct has been recognized. Professor Kahn offers a new merger defense, a shared monopoly defense. If an industry is already anticompetitive then the merger can't make it worse so it is lawful. This is truly new territory for Section 7 Clayton Act cases.

The New York case is also controversial because it uses a new approach to antitrust enforcement that can directly attack market power that is based upon advertising, market segmentation, and other nonprice strategies. This new approach is brand level analysis of pricing power. For this reason the New York and other similar cases have quickly found their way into recent law articles on merger analysis. James Keyte, (1995) for example, argues that the new economic and econometric analyses of market definition and market power advanced in this case and by Shapiro and Baker are too narrow. Speaking for the defense bar he would qualify the analysis with a less technical, more wide ranging discussion reminiscent of Brown Shoe (1954). This is more than a trivial technical issue.

In the 1970's and early 1980's the analysis in the cereal case focused upon tacit collusion

In the 1970's and early 1980's the analysis in the cereal case focused upon tacit collusion and attempted to use company price announcements and the timing of price changes to prove its existence. That case attempted to extend the reach of Section 2 of the Sherman Antitrust Act from single firm monopoly to the "shared monopoly" of a tight oligopoly that practices tacit collusion. Note that the New York case is a Section 7 Clayton Act merger case wherein the issue is the impact of the merger upon market power, i.e. the ability to raise the prices consumers pay. The intent is to stop concentration before firms can exercise market power or if they possess much power, to prevent its consolidation or persistence through the acquisition of competitors.

In the mid 1980's Deneckere and Davidson, (1985) and others including Shapiro established that mergers that increase market shares even a small amount can elevate price in an industry without tacit or explicit collusion.

Jonathan Baker working with Breshnahan (1985) demonstrated that one can analyze demand relationships at the brand level in industries such as cereal to measure brand level price elasticities of demand and evaluate the impact of a merger upon prices. Essentially if the merger is between two brands that compete with each other (high cross price elasticities) then the merger internalizes and eliminates the price depressing effect of this competition. Each brand's demand is more inelastic after the merger. Not only are the prices of the merged brands higher, a ripple effect leads other nearby brands to elevate prices (Werden and Rozanski).

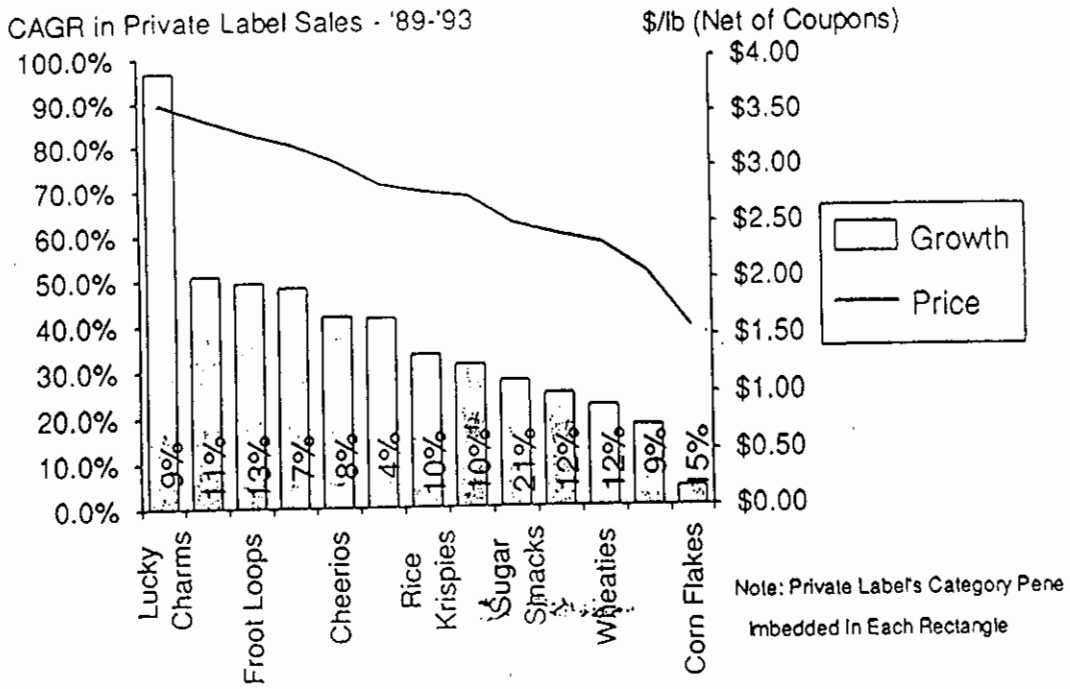
Working with a massive Information Resources Inc database collected from supermarket scanners throughout the nation, faculty and students at the University of Connecticut Food Marketing Policy Center have demonstrated that one can estimate brand level elasticities for a

wide array of brands in industries such as beer, breakfast cereal and soft drinks (Cotterill 1994a, Cotterill 1994b, Cotterill and Langan). Research scientists from Harvard and Yale, are participating in this broad scale effort that includes analysis of private label, brand pricing relationships as well.

The significance of the recent theoretical advances and new empirical research based upon scanner data is that antitrust enforcement agencies are now extending the concept of the unilateral market power from dominant firm industries to differentiated product industries. The Merger Guidelines explicitly discuss dominance and suggest that a merger that produces a market share greater than 35 percent is likely to be challenged. However, if one reads the guidelines carefully this high share creates no safe harbor for mergers in differentiated product industries (Willig p. 299-305, Shapiro p. 5). In an industry such as cereal it is entirely possible, as the State of New York argued, that a merger that places Grape Nuts and Shredded Wheat, two close substitutes in the simple health nutrition segment of the market, under common management can result in the exercise of market power in this corner of the market. Consumers who eat Shredded Wheat don't regard a kid cereal such as GM Lucky Charms as a viable substitute product. Market power may surface after this type of merger even though the market shares of the two brands in the entire cereal industry are very low, approximately 2.5 and 3.0 percent in the Grape Nuts Shredded Wheat case.

To summarize, the antitrust enforcement agencies have new tools and methods to evaluate market power in differentiated industries. Effectively extending merger analysis to the brand level to attack market power that rests upon advertising and segmentation strategies is revolutionary. To date, however, in several cases (New York v. Kraft General Foods, U.S. v.

Figure 4. Relationship Between High Prices and Private-Label Growth



Note: Percent in rectangle reflects private-label penetration in the given category.
Source: IRI, PIM, corporate reports, and Bernstein estimates.

Source: Galbraith, S. 1994. *The Cereal Industry: Pain and Reform; The Cycle Turns.* Bernstein Research.

Gillette, Pennsylvania v. Russell Stover Candies) the analysis has not carried the day for the government. In the recent Continental Bakeries case, however it did (Shapiro). Perhaps antitrust enforcement will be more effective for consumers. However, many large consumer products firms including cereal manufacturers have a vested interest in preserving market power that rests upon advertising and segmentation.

Shifting now to the final major issue, can the market correct itself via expansion of private label breakfast cereals? The top four firms in this industry regard private label as the enemy. Although consumers find private label attractive these firms continue to refuse to do private label because its expansion reduces the profitability of their brands. Instead the leading companies have recently laid off production workers and closed plants. Private label is produced primarily by Ralcorp and two smaller firms, Malto Meal and Gilster Mary Lee. Figure 4 illustrates that high prices attract private label activity.

Steve Gailbraith explains the conventional wisdom concerning the ability of private label to be successful only where the gouge gap is high and the target brand has a large market share. He writes:

> "Private-label products will continue to gain volume share given the "gouge gaps" between private-label and branded alternatives; we expect private-label and value brands to make up around 12% of the market by 1998 (up from 9% today). Furthermore, a broader array of stockkeeping units (SKUs) are at risk than ever before as higher-margin extruded and puffed products like Kix, Froot Loops and the various Cheerios line extensions have grown to sufficient size (2% of the market) to be attractive targets for private-label producers ... (Gailbraith, p. 17).

Private label competition has induced lower brand prices for roughly 35-40 percent of the cereal market, however nearly half of the market is effectively protected from private label

by extensive segmentation and differentiation. Rather than competing on price, this has been the preferred strategy by the top four firms in their battle against private label.

Private label may expand beyond its current 10% volume share level, however gains will probably be slower than in the past. The rate of expansion also depends upon retailers. They actually make more profit on private label cereal than branded cereal and thus have an incentive to expand private label. There also are supply channel management issues that suggest a long run shift beyond copy cat private labels to aggressively managed and promoted retailer lines of private label cereals.

The British experience is instructive. J. Sainsbury, the leading retailer has extensive own label products that account for two thirds of its sales. Behind Kelloggs with approximately 50 percent share, Sainsbury is the number two cereal supplier in its stores with approximately 30 percent of sales. This type of market structure is preferable to, one where, for example Kelloggs has 50% and the number two firm is General Mills with 30 percent. When several supermarket chains jointly occupy the number 2 position each has only a portion of the market wide 30% share for private label. These firms do not jointly price and promote that 30% share as General Mills would. Therefore effective market concentration is lower. Moreover even if the retail market is highly concentrated and retailers exercise market power, increasing private label share would benefit consumers to the extent that it eliminates the double marginalization that occurs when a powerful cereal industry sells to a powerful retailing industry. Integration of two successive monopolists lowers prices and increases output. They move from the "double" to the "single" monopoly price level. Prices are, however still not at the lower competitive level.

its very lumpy promotion activities makes this industry one of the most delinquent examples of efficient consumer response (ECR) management principles. Production is sporadic and consumers are encouraged to pantry load when their favorite brands are on special (Gailbraith). In fact one consumer reporter has made a reputation with advice on how to pantry load to "beat" the industry's huge prices (Cooperrider). This is another economic pathology generated by the lack of price competition in this industry. It sends the wrong signal to consumers because it encourages them to behave in a manner that makes cereal distribution more expensive. Private label cereals under retailer control can avoid these practices thereby reducing supply chain and consumer costs.

The second long run advantage for retailers from moving beyond copy cat private label towards the Sainsbury model of consumer recognized lines of quality private label products is the resulting enterprise differentiation that it confers. If a supermarket chain had the consumer trust and reputation for quality merchandise as, for example L.L. Bean or Sainsbury, there would be real economies of scope in advertising and promotion across categories. Those economies would reduce the profitable level of such activities and thereby reduce consumer prices. As I have argued elsewhere (Cotterill 1997), the British retailer led model has much to offer, but it adoption has been shown in the U.S.. The challenge is for U.S. supermarket retailers to view themselves as the captains of the food marketing channel and to develop a new management culture that moves them beyond shop keeping for dominant food manufacturers brands. This does not require confrontation or direct market place attacks upon leading manufacturers. Rather it requires willingness to develop tighter supply channel management relationships with manufacturers that will work with them. Retailer must also develop more

manufacturers. Rather it requires willingness to develop tighter supply channel management relationships with manufacturers that will work with them. Retailer must also develop more category level marketing expertise. Retailers will no longer be able to rely upon manufacturers to tell them what the consumer and trade promotion strategy will be and to provide them with dollars to implement these strategies. One thing is certain, if U.S. supermarket retailers are not up for the challenge, Wal-Mart is. Also the British are coming! J. Sainsbury owns Shaws Supermarkets in New England and recently acquired a major stake in Giant, the leading retailer in Washington and Baltimore.

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Appendix

OCERY MANUFACTURERS OF AMERICA
CERS OF YOUR FAVORITE BRANDS

NEWS

1010 WISCONSIN AVE. NW
SUITE 900
WASHINGTON, DC 20007
PHONE (202) 337-9400
FAX (202) 337-1500

FOR IMMEDIATE RELEASE

CONTACT: Jeff Nedelman or Susan Mickey
202/337-9400

FACT SHEET: CEREAL INDUSTRY

Facts vs. Myths About Breakfast Cereal Pricing and Promotion

Fact # 1: Breakfast cereal provides consumers with real value. Today the average bowl of ready-to-eat cereal--including milk--costs between 25 and 30 cents. Cereal provides consumers with more taste and variety, better nutrition and greater convenience than any other breakfast food.

→ w/ milk
our Brands
≈.31/serv.
1.102

Fact #2: Cereal prices in real terms have risen less than the rate of inflation--between one and two percent annually. As a result of intense industry competition, consumers are actually paying less for many of the top brands. According to a February 22, 1995, opinion issued by New York U.S. District Court Judge Kimba Wood: "(During the four year period 1989 to 1993), the average coupon-adjusted ready-to-eat cereal prices paid by consumers fell relative to the Consumer Price Index. Over the 1989-1993 period, ready-to-eat cereal prices net of coupons increased by 6.6 percent, while the food-at-home Consumer Price Index rose 12.8 percent and the Consumer Price Index for all items rose 16.5 percent."

Fact #3: Cereal manufacturers are extremely competitive, offering consumers more variety--200 plus nationally distributed brands--at a greater range in price than in any other aisle of the supermarket. The cereal market is so competitive that more than 60 new cereals have been introduced in the past five years. As Judge Wood noted: "The combination of ready-to-eat cereals' heterogeneity and the multiple forms competition takes, renders anticompetitive coordinated effects difficult and unlikely."

Fact #4: Competition in the cereal industry is more intense than ever. As documented by Judge Wood, market shares of cereal manufacturers have fluctuated significantly over the years, with a resulting 27 percent decline in industry concentration between 1970 and 1994.

(more)

"Like many other categories of food, the actual price consumers pay for national brand cereal reflects not just the shelf price, as Congressman Schumer mistakenly states. The actual price also includes all price promotions offered by the retailer and coupons offered by manufacturers. Approximately 60 percent of all cereal purchases are made with coupons, more than in any other food category. → How can they be when less than 20% of coupons redeemed w/ value of $460 m out of $8.27 B on sale?

"When all forms of promotion are considered, it is clear that cereals continue to be a great value. Between 1989-1993, the average coupon-adjusted ready-to-eat cereal prices paid by consumers fell relative to the Consumer Price Index. Over the same period, ready-to-eat cereal prices net of coupons increased 6.6 percent, while the food-at-home consumer price index rose 12.8 percent and the consumer price index for all items rose 16.5 percent.

"It is important to note that, by law, cereal manufacturers set only the wholesale price for their products. Actual shelf prices vary. Consumers interested in better value should use coupons and comparison-shop to find the best prices.

"Today, eighty-three percent of consumers purchase food products based on a 'value decision', a combination of taste, nutrition and lifestyle demands. Price is a factor, though not the most important one. National brand research, innovation and performance deliver that value every day. That's why consumers trust and overwhelmingly select national brands.

"National brand cereals offer consumers excellent value. Cereals are 'nutritionally dense' – a good source of fiber, complex carbohydrates, fortified with antioxidants, essential vitamins and minerals, with low fat or no fat. At an average cost of between twenty-five and thirty cents per serving – including milk – consumers are hard pressed to find another food product that delivers comparable value in terms of quality, taste, nutrition, and convenience. That's why cereal is the most frequently consumed breakfast food and consumption is growing three times as fast as the population."

###

GMA is an organization representing companies that make and market the world's best-known brands of food and consumer packaged goods. GMA is the industry voice on public policy and industry productivity issues, through strategic issues management involving government relations, communications, legal, regulatory, scientific and education advocacy. GMA member company sales, totaling $360 billion, represent the largest volume (85%) of all food and consumer packaged goods sold in the U.S.

Cereal Facts continued...

Fact #5: Cereal manufacturers set only the wholesale prices. Actual shelf prices vary significantly across the country. As Judge Wood noted: "Although wholesale list prices for RTE cereal products are set by manufacturers, retail prices are set completely independently by retailers based on the retailers own competitive circumstances...

Despite a uniform national wholesale price, there are dramatic differences in retail prices charged for the same cereal from region to region and from store to store within a given region.." Judge Wood noted that "the average unpromoted retail price of an 18-oz. box of Post Toasties as of October, 1993, ranged from a low of $1.60 at Farm Fresh in Richmond (Va.) to a high of $3.23 at Food 4 Less/Boys/Viva in Los Angeles."

Fact #6: Consumers benefit from coupons because coupons significantly reduce the prices consumers pay. As Judge Wood noted: "When coupons are taken into account, the average ready-to-eat cereal price per pound paid by consumers increased by 16 cents from 1989 to 1993, from $3.32/lb. to $3.48/lb., an increase of 6.9 percent." Judge Wood further noted: "In the same time period, average coupon-adjusted ready-to-eat-cereal prices paid by consumers fell (emphasis added) relative to the Consumer Price Index. Over the 1989-1993 period, ready-to-eat cereal prices net of coupons increased by 6.6 percent, while the Food-at Home Consumer Price Index rose 12.8 percent and the All Items Consumer Price Index rose 16.5 percent."

Fact #7: Cereal prices in the U.S. are not as high as cereal prices in many other countries. According to market research data compiled by A.C. Nielsen, in 1994 the average U.S. price/lb. for cereal was $3.00 compared to $4.57/lb. in Austria, $4.28/lb. in Greece, $3.84/lb. in Switzerland, $3.22/lb. in Italy, and $2.75/lb. in France.

GMA is an organization representing companies that make and market the world's best-known brands of food and consumer packaged goods. GMA is the industry voice on public policy and industry productivity issues, through strategic issues management involving government relations, communications, legal, regulatory, scientific and education advocacy. GMA member company sales, totaling $360 billion, represent the largest volume (85%) of all food and consumer packaged goods sold in the U.S.

# # #

Table 1. Consumer Price Indices for Food-at-Home and Selected Food Categories

	Food-at-Home	Cereal	Cookies	White Bread	Pasta	Milk	Carbonated Soft Drink	Snacks	Distilled Spirits	Beer	Processed Fruits & Veg	Sweets	Seasons, Spices & Sauces
1983	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1984	103.7	105.4	108.6	104.8	101.2	103.0	100.8	104.7	101.6	105.1	105.3	105.1	103.7
1985	105.2	111.4	112.2	107.5	102.5	101.4	101.8	108.8	112.6	107.3	106.4	108.9	106.8
1986	108.3	117.4	116.3	108.3	101.5	103.4	101.7	112.2	113.4	109.2	105.2	112.6	110.1
1987	112.9	124.2	121.1	113.1	106.3	104.8	103.3	115.7	114.8	111.5	110.0	114.7	113.2
1988	117.7	133.0	128.7	125.5	118.4	110.1	104.6	121.2	117.0	114.6	121.9	119.4	118.3
1989	125.3	148.0	139.0	133.2	120.1	123.0	109.8	126.2	122.1	120.0	124.9	123.6	124.9
1990	133.5	158.8	147.2	138.3	122.7	126.0	110.8	131.1	128.1	124.3	131.6	129.8	132.6
1991	137.0	168.3	154.2	140.4	126.3	125.5	111.9	132.8	139.9	139.0	129.7	136.0	137.9
1992	138.0	175.6	157.7	146.1	128.9	127.8	113.7	132.5	141.8	142.9	131.4	137.3	143.6
1993	141.4	183.5	163.2	156.2	131.7	130.6	115.6	136.3	143.1	143.3	133.2	138.4	147.4
1994	145.4	190.8	169.2	160.4	139.5	131.1	115.2	138.7	144.2	143.2	133.8	139.1	150.9
1995	150.2	192.7	171.6	169.3	142.8	133.7	118.5	143.4	145.5	144.1	137.5	142.7	156.8

Source: Food Marketing Policy Center, University of Connecticut, *Consumer Price Index Detailed Report*, Bureau of Labor Statistics, February, 1996, Table 25 Historical Price Index. Recalculated 6/13/96.

Table A2. Price-Cost-Margins, Recent Census Years.

	SIC*	Industry	1982	1987	1992
1)	20	All Food Industry Average	22	28	30
2)	2043	Cereal	54	65	67
3)	2052	Cookies and Crackers	43	48	49
4)	2051	Bread	35	43	41
5)	2098	Macaroni & Spaghetti	38	45	43
6)	2026	Milk	14	19	19

Source: Food Marketing Policy Center, University of Connecticut, compiled from 1992 Census of Manufactures Preliminary Report, Summary Series, Table 2; Subject Series, 1982, Table 2.
*SIC is Standard Industrial Classification. Census uses these numbers to identify particular industries in their documents.

Table A3. Production Worker Costs and Cost of Materials as a Percent of Value of Shipments: Recent Census Years.

SIC*	Industry	1982	1987	1992
Production Worker Costs				
20	All Food Industry	5.86	5.73	5.79
2043	Cereal	8.23	7.29	6.10
2052	Cookies and Crackers	12.06	11.15	9.70
2026	Bread	11.58	10.56	11.23
2098	Macaroni & Spaghetti	8.33	8.66	7.74
2051	Milk	3.65	3.83	4.08
Cost of Materials				
20	All Food Industry	68.52	63.31	61.21
2043	Cereal	35.70	25.43	25.22
2052	Cookies and Crackers	40.31	35.54	36.55
2026	Bread	40.19	35.12	36.92
2098	Macaroni & Spaghetti	48.32	41.51	45.31
2051	Milk	78.24	73.77	72.76

Source: Food Marketing Policy Center, University of Connecticut, compiled from 1992 Census of Manufactures Preliminary Report, Summary Series, Table 2; Subject Series, 1982, Table 2.
*SIC is Standard Industrial Classification. Census uses these numbers to identify particular industries in their documents.

Table A4. Breakdown of Retail Price of Cold Cereal

	% of mfr Price	$	% of mfr Price	$	% of mfr Price	$	$	% of Retail Price
1. Assume the retail price is: (You will get this from your store price check)							$3.00/lb	100.0
2. Estimated retailer gross margin on cereal is 20%, so the cereal manufacturer's (wholesale) price to the retailer is 0.8 x $3.00 = $2.40/lb Retailers share of the $3.00 price is:							$.60/lb	20.0
3. Breakdown of Mfr. price:			100.0				$2.40/lb	80.0
3a. Mfr. Cost of goods sold					45.5%	$1.09		36.3
3a1. Grain			6.5	$.156				5.2
3a2. Other Ingredients			8.5	$.204				6.7
3a3. Packaging			11.5	$.276				9.2
3a4. Labor			6.5	$.156				5.2
3a5. manufacturing Costs*			12.5	$.300				10.0
Subtotal			45.5					
3b. Mfr. Gross Margin					54.5	$1.31		43.7
3b1. Marketing Expenses			37.5	$.90				30.0
3b1a. Advertising	13.0	$.31						10.3
3b1b. Consumer Promo (mfr coupons)	14.5	$.35						11.7
3b1c. Trade Promo (retail in-store)	10.0	$.24						8.0
3b2. Operating Profit (earnings before interest and taxes)			17.0	$.41				13.7

* Includes capital costs (depreciation)

Source: Food Marketing Policy Center, University of Connecticut, based upon estimates in CS First Boston Reports "Kellogg Company," New York, October 25, 1994. Similar estimates are available from other sources including Ralston and Co. "The Ready to Eat Cereal Industry." Cleveland, February, 1989.

WORLD CLASSICS 100% STONE GROUND WHOLE WHEAT BREAD

lutrition Facts
erving Size: 1 slice (35.8g/1.3oz)
ervings Per Container 19

Amount Per Serving	
alories 90	Calories from Fat 10
	% Daily Value*
otal Fat 1.0g	2%
aturated Fat 0g	0%
holesterol <5mg	0%
odium 150mg	6%
otal Carbohydrate 16g	5%
ietary Fiber 2g	6%
ugars 2g	
rotein 4g	

tamin A 0%	•	Vitamin C	0%
alcium 2%	•	Iron	6%
iamin 16%	•	Riboflavin	10%
acin 10%			

*Percent Daily Values are based on a 2,000 calorie diet. Your Daily Values may be higher or lower depending upon your calorie needs.

Nutrients	Calories:	2,000	2,500
Total Fat	Less than	65g	80g
Saturated Fat	Less than	20g	25g
Cholesterol	Less than	300mg	300mg
Sodium	Less than	2,400mg	2,400mg
Total Carbohydrate		300g	375g
Dietary Fiber		25g	30g

Calories per gram
Fat 9 • Carbohydrate 4 • Protein 4

INGREDIENTS: WHOLE WHEAT FLOUR, WATER, HIGH FRUCTOSE CORN SYRUP, WHEAT GLUTEN, WHEAT BRAN, YEAST, PARTIALLY HYDROGENATED CANOLA AND/OR SOYBEAN OIL. CONTAINS 2% OR LESS OF EACH OF THE FOLLOWING: SALT, HONEY, MOLASSES, ROLLED WHEAT, DOUGH CONDITIONERS (SODIUM STEAROYL LACTYLATE, ETHOXYLATED MONO AND DIGLYCERIDES, MONOGLYCERIDES), CALCIUM PROPIONATE (A PRESERVATIVE).

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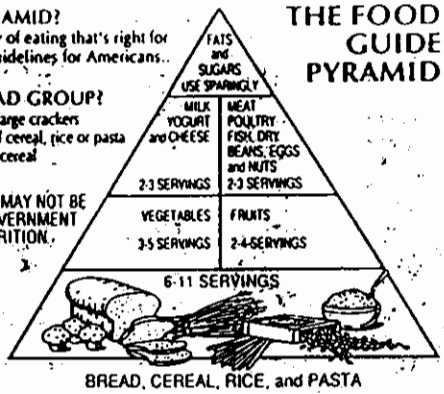
WHAT IS THE FOOD GUIDE PYRAMID?
It's a general guide that lets you find a healthy way of eating that's right for you. The Pyramid is based on the U.S. Dietary Guidelines for Americans.

WHAT IS A SERVING FROM THE BREAD GROUP?
- 1 slice of bread
- 1/2 hamburger bun or English Muffin
- a small roll, Biscuit or muffin
- 3-4 small or 2 large crackers
- 1/2 cup cooked cereal, rice or pasta
- 1 ounce of dry cereal

IN CASE YOU WONDER... THE SERVING SIZE ABOVE MAY NOT BE THE SAME AS ON THE NUTRITION LABEL. THE GOVERNMENT USES DIFFERENT RECOMMENDATIONS FOR NUTRITION EDUCATION THAN FOR PACKAGE LABELS.

THE FOOD GUIDE PYRAMID



0 36800 46016 4

Nutrition Facts

Serving Size 1 bagel (113g/4.0oz)
Servings Per Container 6

Amount Per Serving	
Calories 310	Calories from Fat 20
	% Daily Value*
Total Fat 2.5g	4%
Saturated Fat 0.5g	4%
Cholesterol 0mg	0%
Sodium 510mg	21%
Total Carbohydrate 62g	21%
Dietary Fiber 3g	12%
Sugars 10g	
Protein 10g	

Calcium 6%	• Iron 15%
Thiamin 30%	• Riboflavin 15%
Niacin 20%	

Not a significant source of vitamin A and vitamin C.

*Percent Daily Values are based on a 2,000 calorie diet. Your daily values may be higher or lower depending on your calorie needs:

	Calories:	2,000	2,500
Total Fat	Less than	65g	80g
Sat. Fat	Less than	20g	25g
Cholesterol	Less than	300mg	300mg
Sodium	Less than	2,400mg	2,400mg
Total Carbohydrate		300g	375g
Dietary Fiber		25g	30g

Calories per gram:
Fat 9 • Carbohydrate 4 • Protein 4

INGREDIENTS: Enriched Wheat Flour (Malted Barley Flour, Niacin, Reduced Iron, Thiamin Mononitrate, Riboflavin), Water, Raisins, High Fructose Corn Syrup, Soybean Oil, Yeast, Cinnamon, Salt, Molasses, Calcium Propionate (a preservative), Vegetable Mono and Diglycerides, Azodicarbonamide (ADA), Ascorbic Acid, Caramel Color.

Big Y®

Cinnamon Raisin Bagels

‡We are so sure you will like our products that we guarantee satisfaction or we will promptly give you a refund. After all, your complete satisfaction is our No. 1 priority.

DIST. BY BIG Y FOODS, INC., 280 CHESTNUT ST., SPRINGFIELD, MA 01104

Kellogg's®

pop-tarts BRUNCH™

CEREAL

Nutrition Facts

erving Size 3/4 Cup (30g/1.1 oz.)
ervings per Container 12

mount or Serving	Cereal	Cereal with ½ Cup Vitamins A & D Skim Milk
alories	120	160
Calories from Fat	5	5
	% Daily Value **	
otal Fat 1.0g*	2 %	2 %
Saturated Fat 0g	0 %	0 %
holesterol 0mg	0 %	0 %
odium 125mg	5 %	8 %
otassium 35mg	1 %	7 %
otal arbohydrate 27g	9 %	11 %
Dietary Fiber 0g	0 %	0 %
Sugars 14g		
Other Carbohydrate 13g		
rotein 1g		
itamin A	15%	20%
itamin C	25%	25%
alcium	0%	15%
on	25%	25%
itamin D	10%	25%
hiamin	25%	30%
iboflavin	25%	35%
iacin	25%	25%
itamin B_6	25%	25%
olate	25%	25%
lagnesium	2%	6%
inc	25%	25%

*Amount in cereal. One half cup of skim milk contributes an additional 65mg sodium, 6g total carbohydrate (6g sugars), and 4g protein.
**Percent Daily Values are based on a 2,000 calorie diet. Your daily values may be higher or lower depending on your calorie needs:

	Calories	2,000	2,500
otal Fat	Less than	65g	80g
Sat. Fat	Less than	20g	25g
holesterol	Less than	300mg	300mg
odium	Less than	2,400mg	2,400mg
otassium		3,500mg	3,500mg
otal Carbohydrate		300g	375g
Dietary Fiber		25g	30g

alories per gram:
at 9 • Carbohydrate 4 • Protein 4

ngredients: Corn and oat flour, sugar, yellow orn meal, partially hydrogenated vegetable oil ne or more of: cottonseed, coconut, and soybean), alt, baking soda, natural and artificial flavors, olor added, red #40, yellow #5, yellow #6, blue #1, **Vitamins and Minerals:** sodium ascorbate and scorbic acid (vitamin C), niacinamide, zinc xide, iron, pyridoxine hydrochloride (vitamin B_6), riboflavin (vitamin B_2), vitamin A palmitate protected with BHT), thiamin hydrochloride (vitamin B_1), folic acid, and vitamin D.

MADE BY KELLOGG USA INC.
BATTLE CREEK, MI 49016 U.S.A.
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Exchange: 1 1/2 Starch/Bread
Exchange calculations based on "Exchange Lists for Meal Planning," © 1989, American Diabetes Association, Inc., The American Dietetic Association.

Kellogg's® appreciates consumer comments
Call 8 am to 5 pm ET: 1-800-962-1718
Write P.O. Box CAMB, Battle Creek, MI 49016-1966

QUAKER

Puffed Wheat

Nutrition Facts

Serving Size 1¼ cup (15g)
Servings Per Container about 11

Amount Per Serving	Cereal Alone	with ½ Cup Vitamin A&D Fortified Skim Milk
Calories	50	90
	% Daily Value**	
Total Fat 0g*	0%	0%
Sodium 0mg	0%	3%
Potassium 55mg	2%	7%
Total Carbohydrate 11g	4%	6%
Other Carbohydrate 10g		
Dietary Fiber 1g	6%	6%
Sugars 0g		
Protein 2g		
Vitamin A	0%	4%
Vitamin C	0%	2%
Calcium	0%	15%
Iron	2%	4%
Thiamin	4%	6%
Niacin	8%	8%

Not a significant source of Calories from Fat, Saturated Fat, Cholesterol.
*Amount in Cereal. One-half cup skim milk contributes an additional 40 Calories, 65mg Sodium, 6g Total Carbohydrate (6g Sugars), and 4g Protein.
**Percent Daily Values are based on a 2,000 calorie diet. Your daily values may be higher or lower depending on your calorie needs:

	Calories:	2,000	2,500
Total Fat	Less than	65g	80g
Sat Fat	Less than	20g	25g
Cholesterol	Less than	300mg	300mg
Sodium	Less than	2,400mg	2,400mg
Total Carbohydrate		300g	375g
Dietary Fiber		25g	30g
Potassium		3,500mg	3,500mg

Calories per gram:
Fat 9 • Carbohydrate 4 • Protein 4

Ingredients: Puffed wheat, ferrous sulfate, niacinamide*, citric acid, thiamin mononitrate*.
*One of the B vitamins.

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THE QUAKER OATS COMPANY
P.O. BOX 049003
CHICAGO, IL 60604-9003

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CHEERIOS

Good Source Of Fiber
Made With Whole Grain Oats

Nutrition Facts

Serving Size 1 cup (30g)
Servings Per Container About 9

Amount Per Serving	Cheerios	with ½ cup skim milk
Calories	110	150
Calories from Fat	15	20
		% Daily Value**
Total Fat 2g*	3%	3%
Saturated Fat 0g	0%	2%
Cholesterol 0mg	0%	1%
Sodium 280mg	12%	14%
Potassium 90mg	3%	8%
Total Carbohydrate 23g	8%	10%
Dietary Fiber 3g	11%	11%
Sugars 1g		
Other Carbohydrate 19g		
Protein 3g		
Vitamin A	25%	30%
Vitamin C	25%	25%
Calcium	4%	20%
Iron	45%	45%
Vitamin D	10%	25%
Thiamin	25%	30%
Riboflavin	25%	35%
Niacin	25%	25%
Vitamin B_6	25%	25%
Folic Acid	25%	25%
Phosphorus	10%	25%
Magnesium	8%	10%
Zinc	25%	30%
Copper	4%	4%

*Amount in Cereal. A serving of cereal plus skim milk provides 2g fat (0.5g saturated fat), less than 5mg cholesterol, 350mg sodium, 290mg potassium, 29g carbohydrate (7g sugars) and 7g protein.
**Percent Daily Values are based on a 2,000 calorie diet. Your daily values may be higher or lower depending on your calorie needs:

	Calories:	2,000	2,500
Total Fat	Less than	65g	80g
Sat Fat	Less than	20g	25g
Cholesterol	Less than	300mg	300mg
Sodium	Less than	2,400mg	2,400mg
Potassium		3,500mg	3,500mg
Total Carbohydrate		300g	375g
Dietary Fiber		25g	30g

INGREDIENTS: WHOLE OAT FLOUR (INCLUDES THE OAT BRAN), MODIFIED FOOD STARCH, WHEAT STARCH, SUGAR, SALT, OAT FIBER, TRISODIUM PHOSPHATE, CALCIUM CARBONATE, VITAMIN E (MIXED TOCOPHEROLS) ADDED TO PRESERVE FRESHNESS.
VITAMINS AND MINERALS: VITAMIN C (SODIUM ASCORBATE), IRON AND ZINC (MINERAL NUTRIENTS), A B VITAMIN (NIACIN), VITAMIN B_6 (PYRIDOXINE HYDROCHLORIDE), VITAMIN B_2 (RIBOFLAVIN), VITAMIN A (PALMITATE), VITAMIN B_1 (THIAMIN MONONITRATE), A B VITAMIN (FOLIC ACID), VITAMIN D.

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Exchange calculations based on the *Exchange Lists for Meal Planning*. © 1989 the American Dietetic Association, the American Diabetes Association.

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