



AgEcon SEARCH
RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search
<http://ageconsearch.umn.edu>
aesearch@umn.edu

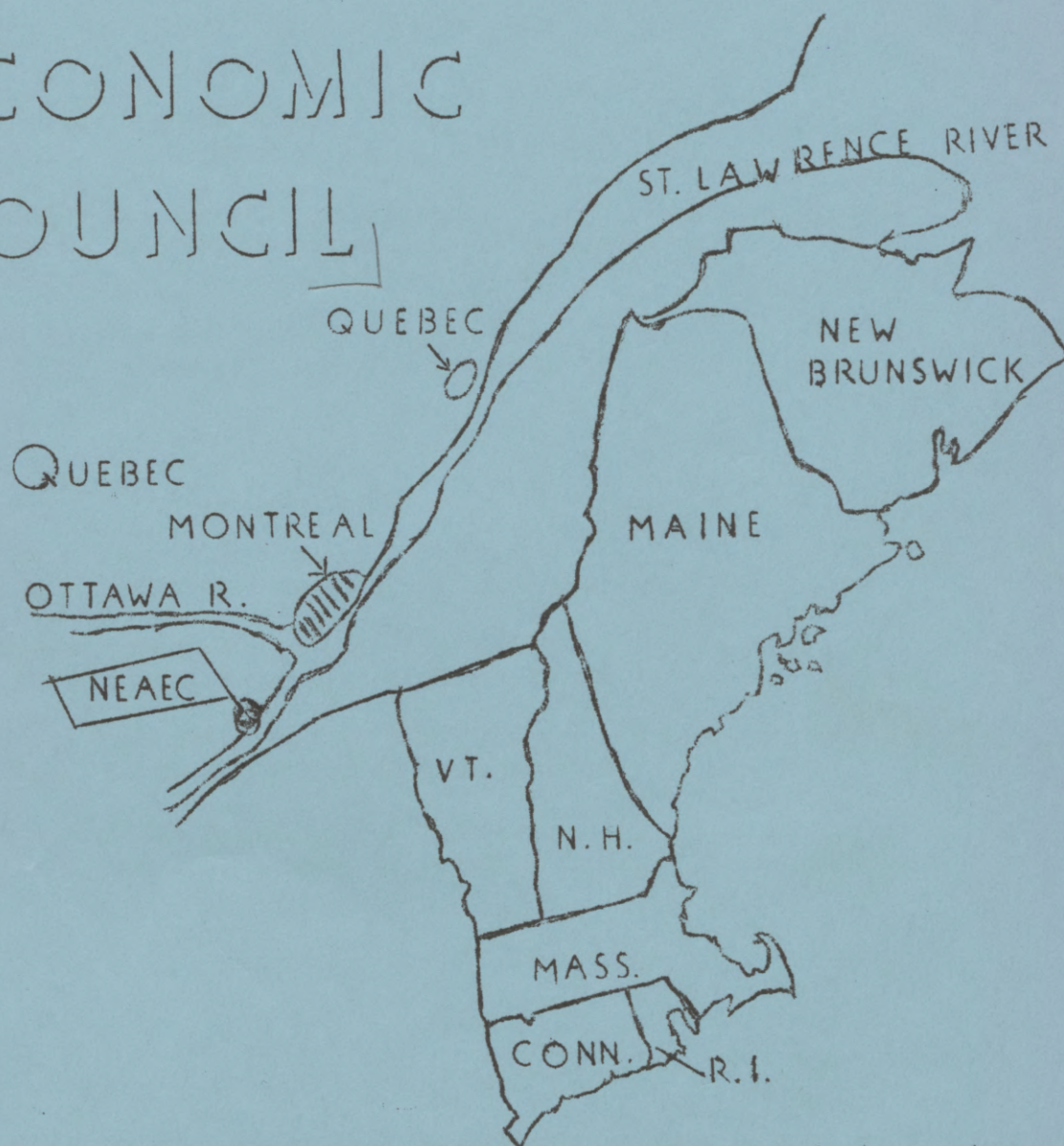
*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

CEA (pl)

NEW ENGLAND AGRICULTURAL ECONOMIC COUNCIL

GIANNINI FOUNDATION OF
AGRICULTURAL ECONOMICS
LIBRARY

JUL 18 1961



PROCEEDINGS, JUNE 1960
AT
MACDONALD COLLEGE - MCGILL UNIVERSITY
STE. ANNE DE BELLEVUE, MONTREAL, QUEBEC, CANADA

ORGANIZATION OF THE CANADIAN FOOD INDUSTRY

Professor H. E. English
Institute for Economic Research
Queen's University, Canada

In its report last fall, the Royal Commission on Price Spreads of Food Products again called attention to a concern over the spread between prices received by farmers and prices paid by consumers for food. It was discovered that while in general, farm prices remained at the same level in 1958 as in 1949, the retail prices paid for the same products, or processed forms of these products were 20 percent higher. Thus, the farmer was found to be receiving 44 percent of the final sales value of his products, whereas in the earlier year he had been getting 59 percent. It was undoubtedly the fact that the farmers sensed this decline in their relative shares that brought about the Royal Commission investigation in the first place, as had been the case in the 1930's and 1940's investigations of the same subject. Formal inquiries into the prices of other commodities and services which are also of great importance to consumers (e.g. drugs and health services) have seldom been undertaken because the distribution of political pressures has not produced a sufficient demand for such studies.

The Price Spreads Commission properly emphasized in its report that general economic circumstance played a large part in the spreading of prices in recent years. On the supply side, there has been the much discussed increase in world production, in part due to the rather remarkable technological advances in agriculture, and in part, the result of the autarchic policies of governments arising in many cases, from fear of recurrence of war time food shortages. On the demand side, there has been the continuing strong consumer demand which has tempted all producers to find means of increasing sales.

However, a strong consumer demand by itself is not likely to raise prices (except perhaps in the very short run) in the face of falling supply prices at the raw material stage, especially when this stage is competitively structured. The Commission therefore found it necessary to examine the structure and behavior of the processing and distributing industries to discover whether they might have been in a position to increase the income elasticity of their products and to reduce their price elasticity.

Processing Industries

For the Food Processing group as a whole, the changes in gross margin calculated by the staff of the Commission has been from about 30 percent in 1949 to nearly 37 percent in 1957. The greatest changes were from 1951 to 1952 when the percentage rose from 30 to 34 percent and from 1954 to 1955 when it rose a further two percentage points.^{1/} This evidence fits in very well with the fact that the greatest declines in farm prices occurred following the 1951 Korean inflation peaks, and again after the production increase in 1955 following lower 1954 levels. Prices of processed goods were apparently sticky in periods of downward tendency in prices of raw materials.

The explanation of these statistical indicators may be found in the structure and behavior of the processing industry sectors. A study of concentration in these industry groups, done by the staff of the Price Spreads Commission^{2/}, indicates that, in the majority of sectors of the industry, three or four large firms control more than half of the sales. The following three groups may be usefully distinguished (in each case, within the list, in descending order of concentration):

^{1/} Price Spreads Commission Report, vol. 1, p.22, Table 2.

^{2/} Ibid., vol. 3, p.89-103,

Four firms control 75% or more of sales:

prepared breakfast foods, processed cheese, sugar, flour, and animal oils and fats.

Four firms control 50-75% of sales:

meat packing, biscuits and crackers, condensed milk, and vegetable oil mills.

Four firms control 20-50% of sales:

Sausage and sausage casings, fruit and vegetable processing, "other" dairy products, bread and bakery products (other than biscuits, etc.), fish packing and curing, and butter and cheese.

Except for flour milling there do not appear to have been significant increases in concentration in the period studied. By comparison with food processing in the United States, the Canadian industries are more concentrated, a natural result of similarity of product and technology but dissimilarity of market size. The difference is particularly significant for meat packing and breakfast foods. In the United States, the four largest firms control only about 40% of the sales.

Such measurements of concentration must be used cautiously. Vigorous price or product competition may occur even when there are two or three large firms. On the other hand, the existence of a leading firm may increase effective concentration even where several smaller competitors exist. The importance of local or regional monopolies may be covered up by concentration measures based on national market statistics. This latter point is supported by the fact that since the War, combines investigations have occurred in Canada in the bread and bakery products and fish packing industries as well as in the flour milling and sugar refining.^{3/}

Nevertheless, it would appear significant that the greatest increases in processor margins have occurred in flour milling, meat packing, sugar refining and breakfast food preparation, all of these being at the upper end of the concentration scale.

Of course, these gross margins have a variety of meanings. In some cases, they reflect important changes in the extent of processing (e.g. in cake and pie mixes and frozen meats) or the introduction of conveniences of selection and packaging, (small cuts of meat, cut-up poultry), but in all cases the margins do reflect a choice of non-price competition. Only in the instance of prepared breakfast foods has the profit on investment been well above the average for all Canadian manufacturing - 25-32 percent after taxes for the three largest firms during the 1951-56 period.

The contribution of the processors to price spreads may then be summarized as being largely the result of the exploitation, by an already concentrated oligopoly, of favorable demand conditions and abundant supplies of raw food after 1951. There is also some evidence that the spread may have been increased by the processors' oligopsony power over farmers, though this may be mitigated by the countervailing power of co-operative marketing agencies.

^{3/} The reports emerging from these investigations are worthy of study for evidence of the particular characteristics of Canadian processing and manufacturing industry. The sugar refining industry, in spite of its dependence on an important raw material, is particularly representative of the variety of factors affecting competition in Canadian manufacturing. See Restrictive Trade Practices Commission Report concerning the Sugar Industry in Eastern Canada, Queen's Printer, Ottawa, 1960.

Food Distribution

The increase in distributive margins has been exclusively at the retail level. Wholesale margins have in fact declined, though this may, to some extent, be attributed to the tendency of large retailers to incorporate wholesaling functions in retailing. Retail margins have edged upward during the period studied but not by as much as processors' margins. The chain combination (grocery, meat, etc.) stores have experienced a rise from 15.6 percent to 17.4 percent in gross margin while independent combination stores rose from 14.6 to 15.4 percent.^{4/} The gross margins of both chain and independent meat markets rose more significantly, from about 17 to 20 percent in each instance. It is interesting that only in the case of combination stores was there very much difference between margins of chains and independents. Chain and independent grocery stores both had margins of about 15 percent while chain and independent meat stores had 20 percent margins. It is also notable that changes in retail margins were not continuously upward for the period.

As in the discussion of processing, the explanation may first be sought in the structure of distribution. Whereas, there was no overall increase in concentration in processing, there has been an increase in concentration in retailing. Between 1930 and 1949, the sharing of retailing activities had been rather consistently 70 percent independent and 30 percent chain. Between 1949 and 1958, however, the independents' share dropped to 56 percent, though this percentage masks significant regional variation, from 41 percent in Ontario to 78 percent in the Maritime provinces. Four big chains do more than half of the grocery and combination store business in Ontario. Voluntary chains among independents have also increased greatly in importance in the same decade; and are now estimated to handle about 20 percent of grocery and combination retailing. The result of these changes has been the emergence of oligopoly attitudes in the retailing business, the realization by the chains that changes in their major selling policies will affect their rivals' business. The resulting selling policy pattern includes short-term price competition in particular products, increasing variety of product (including an expanding range of non-food items, services and conveniences), and promotional "gimmicks" ranging from trading stamps to children's encyclopedias.

The reason for this pattern may be found in the factors that gave rise to the success of the chain combination supermarket. Large distribution units in retailing have succeeded primarily because their promoters exploited the shopping center opportunity offered by suburban development and the wider use of the automobile. There is no essential reason why independents could not have exploited this opportunity - most shopping centers include numerous independents in non-grocery lines. The fact that chains were able to command better managerial talents, along with the new technology for mass merchandising of food at the retail level has probably helped to ensure their success. But these factors seem to have done little more than compensate for the traditional disadvantages of large scale retailing - the complexities of handling so many lines of product and the locational concentration. In this context, the selling policy already described is easy to comprehend. Whereas, costs have prevented the chains from adopting a generally lower price level than independents, reduced margins on individual products have been effectively used for customer attraction.^{5/}

^{4/} The figures for chains are for 1949 and 1957, while independent store margins are for 1948 and 1956, because surveys are made on alternative years. Grocery chains (as opposed to combination chains) and independents show different trends in margins, the chains downward, the independents upward, the result being that margins were almost the same percentages by the late 1950's. See Report, vol. 1, p.22, Table 1.

^{5/} However, it is important to note that this particular form of promotion is most easily matched by smaller independents. The Report of the Enquiry into Loss Leader Selling, Ottawa, 1955, may be cited in support of this.

Customers have been drawn by the very fact that so many day-to-day needs (for example, hardware and "drugstore" items) may be obtained at the "grocery" store. Through the trading stamp, the supermarket further extends its range of goods and attracts customers with a form of advertising, which, however much consumer groups rail at it, is vastly more practical in the eyes of the housewife than colored magazine "ads" and singing commercials. Thus, non-price competition (which paradoxically, must be defined so as to include slashed margins on a few items) emerges in a situation where comprehensive price competition is impossible for sound cost reasons, and is discouraged in any case by the processor-suppliers who press their own differentiation bias on willing retailers. So together they strain every mental muscle to make homogeneous food products non-homogeneous in the consumers' eyes. It is not surprising that the result has been higher margins, particularly in the combination chain store with its greater stress on non-grocery and non-food items. But the greater rise in margins of meat markets (both chain and independent) should remind us that the source of the rise in margins even at the retail level is often the effort of processors to promote differentiation in every form.

Conclusions Concerning Effects

The effect of these increased price spreads is perhaps less felt by the farmers, who have played the key role to bring about the investigation, than by the consumers. The farmer as a consumer retains more freedom of choice between "raw" food and service-laden food products, and it is doubtful that his income has been much reduced by the higher prices which larger margins have made necessary. The effect on his income whatever price elasticity exists in the demand for agricultural food products may well have been balanced by the promotional effects (however small) of new products or new forms.

The consumer on the other hand has been guided into new habits which only partly represent rational preference because they are the result of the private "educational" efforts of those whose basic motivation is to sell rather than to inform. Further the consumer's "education" is unbalanced, depending upon the incidence (and specific nature) of oligopoly in the various food industries. The Price Spreads Commission rightly emphasizes the need to counteract misleading advertising and to control the use of selling "gimmicks" which are of doubtful value to consumers as food buyers, but it unaccountably casts doubt on the appropriateness of consumer research agencies. In a country in which persuasion is regarded more highly than social control, it seems to me that more serious consideration should be given to a government-subsidized consumer research and reporting body. The effect need not be, as the Commission suggests, a net increase in expenditure on commercial information, for if the measure were successful it would reduce the profitability of private advertising and promotional activities. The alternative which the Commission recommends, "that the Association of Canadian Advertisers, in co-operation with the Food Industry, be requested to draw up a code of ethics designed to guide food advertisers", seems a little like giving the control of alcoholic beverage consumption to the brewers and distillers.

As for the maintenance of competition in processing and retailing, the main proposals of the Commission are that the independent retailer should be aided by control of those promotional allowances by which processors subsidize the gross margins of the chains. The recently proposed amendments of the Canadian Combines Act include a section which is intended to deal with these allowances, but leaves unchanged the ineffective provisions concerned with price discrimination, a practice which may well be encouraged if promotional allowances are curtailed.

Concentration at the processing stage is not likely to be much affected by the proposals of the Commission. The Combines Investigation branch is encouraged to maintain its interest in buying and selling practices of large business organizations. On the buying side, the Commission did not, however, feel sufficiently confident that increased use of cooperative marketing agencies would increase the "countervailing power" of primary producers to include this as a recommendation, though it does mention it as a possibility.

On the selling side, there were no specific recommendations except for the attack on promotional allowances. No mention is made of the use of any effective source of new competition; such as the control of mergers, which have been rather common in food processing and distribution, or reduction of tariffs, where this action might be relevant.

In general, one feels compelled to conclude that while the Price Spreads Commission has added to our understanding of the economics of the food industries in Canada, it has not recommended new means for making the relevant markets significantly more competitive or better informed.