U.S. Baking Industry Responds to Consumers

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Consumers' desire for convenience, service, and variety are helping to boost the demand for bakery products. Many consumers purchase freshly baked goods from in-store bakeries and retail outlets rather than use their scarce leisure time to prepare items from scratch. And the choice consumers have among bakery products is extremely large.

To meet the demand for greater food variety in the late 1970's and 1980's, manufacturers introduced many new bakery products, launching 1,155 new items in 1989 alone. Partly because of these efforts, items once considered strictly specialties—such as bagels and pita bread—have gained in popularity. Meanwhile, supermarkets accentuate sales from in-store bakeries, while retail bakers emphasize specialty goods and cookies. Restaurants cater to consumer demand for quick, inexpensive sandwiches. All industry segments have tapped into the trend of healthful eating, such as consumers' interest in whole wheat breads and oat bran muffins.

However, the increase in demand for bakery products differs among various segments of the industry and among product types. Per capita consumption of certain wholesale baked goods (such as prepackaged white breads and pies) on average, remained fairly level during the 1980's.

To broaden their markets, wholesalers have often aggressively developed new products and expanded their promotional base. Many industry analysts contend that fresh products from in-store bakeries (mainly located in supermarkets, department stores, and convenience stores) and retail outlets (like Mrs. Fields and T.J. Cinnamons) pose a serious threat to prepackaged products. However, consumers often purchase goods on impulse at in-store and retail outlets. Impulse purchases may not, over time, erode the market share of wholesalers as some observers at one time thought.

Perishability Affects Structure

Wholesale bakers, who sell primarily to food retailers and food service companies, form the backbone of the baking industry. They generated about 56 percent of all bakery sales in 1990 *(figure 1)*.

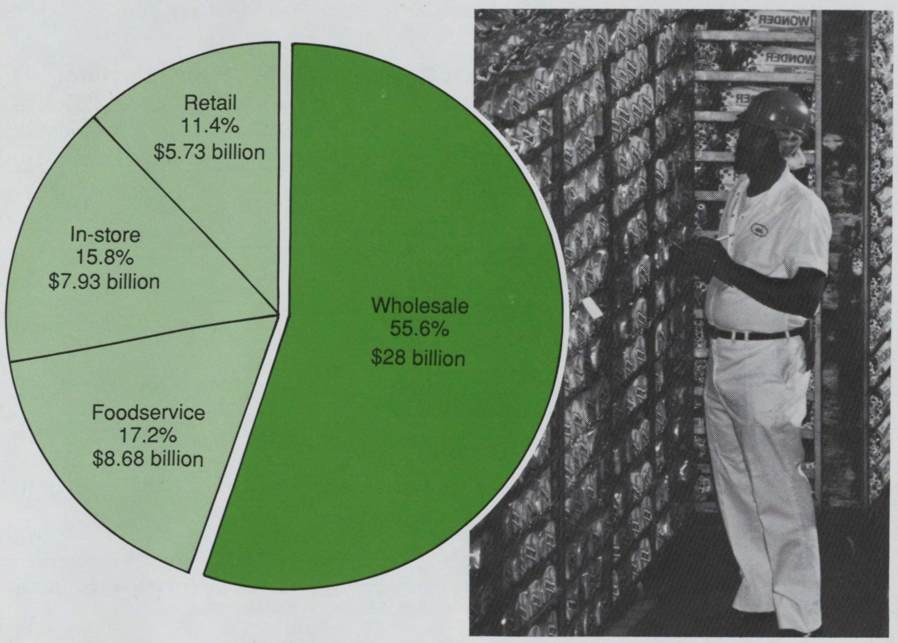
Wholesale baking plants typically are rather specialized. Most factories produce mainly bread and cake items (2,357 plants operating nationally in 1987) or cookie and cracker products (380 plants). Bread-type products have a shorter shelf life than cookies and crackers. Therefore, the bread and cake industry has more local plants close to population centers.

Within each industry segment, there are variations in the items produced. For instance, many plants in the bread and cake industry manufacture only a few distinct items, such as breads and rolls. A few plants make a wider variety of items. For example, one New York plant produces over 19 different items, ranging from bagels to pies and ice cream cones.

Many bread and cake bakeries remain single-plant, family-owned enterprises with fewer than 20 employees. Plants in

Figure 1. Wholesalers Dominate Estimated Baking Industry Sales

Total sales $50.34 billion



Source: "Trends '91". *Bakery Production and Marketing,* June 24, 1990, pp. 44-78.

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this size category accounted for 56.3 percent of all plants in the wholesale bread and cake industry in 1987, but only 2.3 percent of sales. With limited access to capital, many single-plant bakeries find that the costs of refrigerated shipments and the potential for spoilage outweigh the gains of geographic expansion.

This situation means that large, multi-plant wholesalers are important in the industry. Some of these operations, better able to bear the costs and risks of large-scale enterprises, have developed into major businesses. For instance, Continental Baking, the largest bread and cake wholesaler in 1990, operates nationally. Several of the largest bread and cake wholesalers sell their products only in certain regions *(table 1)*.

For cookie and cracker manufacturers, less constrained by product perishability, the economies of scale associated with long production runs surpass any advantages of plant dispersion. Plants with fewer than 20 workers represented 49.7 percent of all plants in 1987, but barely 1.5 percent of total sales. As a result, the large cookie and cracker companies have fewer plants and a more national focus than the large bread and cake firms. For example, Nabisco, the largest cookie and cracker manufacturer in the United States, receives at least 15 percent of its annual sales from each geographic region *(table 2)*.

Table 1. Continental Baking Is the Nation's Largest Bread and Cake Baker [1]

Company	1989 Sales	Area of operation					Share of business		
		North east	South east	Mid west	South west	West	Breads and cakes [2]	Cookies and crackers	Others[3]
	Million dollars	*Percent*							
Continental Baking Co.	1,836	13	12	45	5	25	100	0	0
Campbell Taggart, Inc.	1,400	0	45	15	25	15	90	0	10
Interstate Bakeries, Corp.	1,079	0	36	29	10	25	98	0	2
Flowers Industries, Inc.	782	0	100	0	0	0	100	0	0
Pepperidge Farm, Inc.	548	52	18	18	7	5	71	20	9
Best Foods Baking Group	530	60	20	20	0	0	100	0	0
Entenmann's, Inc.	502	40	8	14	4	34	90	10	0
Sara Lee Bakery	502	20	20	30	10	20	100	0	0

[1]Sales of frozen items are included in the determination of the largest bread and cake companies. [2]Includes pan breads, hearth breads/rolls, soft rolls/buns, sweet goods, cakes, donuts, pies, and English muffins. [3]Includes frozen doughs.

Source: *Bakery Production and Marketing: Red Book 1990.* pp. 24-25. Gorman Publishing Co.

Table 2. Nabisco Is the Nation's Largest Cookie and Cracker Manufacturer [1]

Company	1989 Sales	Area of operation					Share of business		
		North east	South east	Mid west	South west	West	Breads and cakes [2]	Cookies and crackers	Others[3]
	Million dollars	*Percent*							
Nabisco Biscuit Co.	2,163	20	15	30	15	20	0	100	0
Keebler Co.	1,379	18	19	50	6	7	6	84	10
Sunshine Biscuits, Inc.	540	NA	NA	NA	NA	NA	0	100	0
Lance, Inc.	432	20	59	8	13	0	3	56	41
McKee Baking Co.	395	12	42	26	16	4	48	52	0

[1]Sales of certain snack foods are included in the determination of the largest cookie and cracker companies. [2]Includes pan breads, hearth breads/rolls, soft rolls/buns, sweet goods, cakes, donuts, pies, and English muffins. [3]Includes frozen doughs.

Source: *Bakery Production and Marketing: Red Book 1990,* pp 24-25. Gorman Publishing Co.

Bakeries Have Changed Owners

Ownership of wholesale bakeries, whether the companies bake breads, cakes, cookies, or crackers, has evolved in the past 30 years as food processors have acquired baking companies. Within this period, control of every major wholesaler, except Flowers Industries, has changed.

As elsewhere in food manufacturing, many of the changes that occurred in the 1980's involved purchases by large, diversified companies. For instance, Kohlberg, Kravis, Roberts acquired RJR Nabisco Inc., parent of Nabisco Biscuit Company. During this period, Pepperidge Farm, Inc., became a division of Campbell Soup, Inc.; Entenmann's, Inc., a part of Kraft-General Foods; and Sunshine Biscuits, Inc., an operation of G.F. Industries, Inc., a California-based baking company. *(Also see box "Single Transactions Affect Investment Flows.")*

Large companies, already in the baking industry, often purchase other bakeries. An examination of these transactions suggests that the acquisition route has been the best way for many large baking firms to expand geographically. Baking firms have often found that buying distressed plants is cheaper than building new facilities.

At least two factors explain the preference for expansion by acquisition. First, the cost of building a new plant may be as much as twice the cost of buying and renovating an existing plant. Second, the buy-rather-than-build approach avoids adding capacity to a sector where excess capacity is a constant danger.

Acquisitions and mergers have enhanced the financial and marketing resources of the wholesale baking industry. Because many acquiring companies have substantial resources, they can channel large amounts of capital into product development and engage in the advertising necessary to establish and maintain brand loyalty. In addition, the packaging and product technologies of newly formed companies have likely accelerated the pace of new items entering the market.

Single Transactions Affect Investment Flows

Foreign Investment in the Baking Industry Increased During the 1980's

Year	U.S. direct investment abroad	Foreign direct investment in the U.S.
	Million dollars	
1982	352	452
1983	391	485
1984	384	391
1985	647	461
1986	838	796
1987	1,202	702
1988	1,347	815
1989	13	1,030

Source: *Survey of Current Business.* August issues, 1987-90. U.S. Department of Commerce, Bureau of Economic Analysis.

Between 1982 and 1988, foreign direct investment in U.S. baking, as well as U.S. investment in baking abroad, showed a clear upward trend. In the mid-1980's, U.S. outflows exceeded inflows.

But in 1989, both domestic and overseas transactions substantially changed the investment balance.

Individual transactions often have a large impact on aggregate inflows and outflows. In 1989, Kohlberg, Kravis, and Roberts (KKR) sold 23 RJR Nabisco plants in Western Europe for $2.5 billion to BSN, a French food conglomerate. This sale, along with smaller divestitures by other companies, prompted a near-disappearance in U.S. foreign baking investment. KKR's sale of these plants eased repayment of loans incurred by the leveraged buyout of RJR Nabisco. The sale was contrary to the recent trend of U.S. companies investing in Europe in anticipation of EC 1992.

In 1990, the Invus Group, the North American arm of R.T. Holding S.A. of Belgium, purchased General Biscuit of America, Inc., the U.S. biscuit division of BSN. While Invus already has major investments in U.S. bread and roll operations, this acquisition is its first into the U.S. cookie and cracker business. BSN divested its U.S. cookie and cracker operations to concentrate on markets in Europe and Asia.

Wrapped bread is inspected and prepared for shipping.
Photo credit: Continental Baking Company

In-store Bakeries Heighten Competition

Wholesalers, armed with their advertising and product innovation strengths, confronted new competition from a variety of outlets in the 1980's. These suppliers, which typically focus on convenience in service and location, include in-store bakeries, retail bakeries, and food service retailers (which bake goods on premise).

The rapid growth of supermarket in-store bakeries has caused wholesalers to re-examine their products and marketing methods. The number of in-store bakeries increased from 18,200 in 1986 to just over 23,000 in 1990. They generated almost $8 billion in sales in 1990, up from $4.9 billion in 1986. The top-ranked in-store bakery company—Winn-Dixie Stores, Inc.—operated 1,117 units in 1990 *(see table 3)*.

Though in-store bakeries continue to be a dynamic segment of the grocery business, their rate of growth appears to be slowing. This trend is evident in both sales and in-store bakery numbers. For instance, the number of in-store bakeries expanded by about 7 percent annually from 1986 to 1989, but by only 3 percent from 1989 to 1990. Sales rose by about 15 percent per year between 1986 and 1989, but by only about 7 percent between 1989 and 1990 *(figure 2)*.

Some observers stress the competition that in-store bakeries create for wholesalers. They claim that in-store baked goods are often perceived as being fresher and of higher quality. In-store bakeries, often positioned close to store entrances, frequently offer cakes and specialty breads not available elsewhere in the store. In addition, employees at in-store bakeries may be knowledgeable about baked foods, can take special orders, and distribute samples. Unlike their shelf or freezer case purchases of packaged goods, consumers may choose the desired number of items.

Other analysts disagree. These observers contend that in-store bakeries often charge premium prices that consumers will not likely pay on a regular basis. In addition, bake-shop purchases are often made on impulse. Consumers who write "bread" on their shopping lists and buy premium in-store loaves will not typically do so every week. Finally, these analysts point out that some supermarkets have closed unprofitable in-store bakeries.

Regardless of the competition, wholesalers exploit the promotional efforts used by in-store bakeries. Items that have been successful at in-store bakeries, such as specialty items and single-serve units, are now being marketed in prepackaged form by wholesalers.

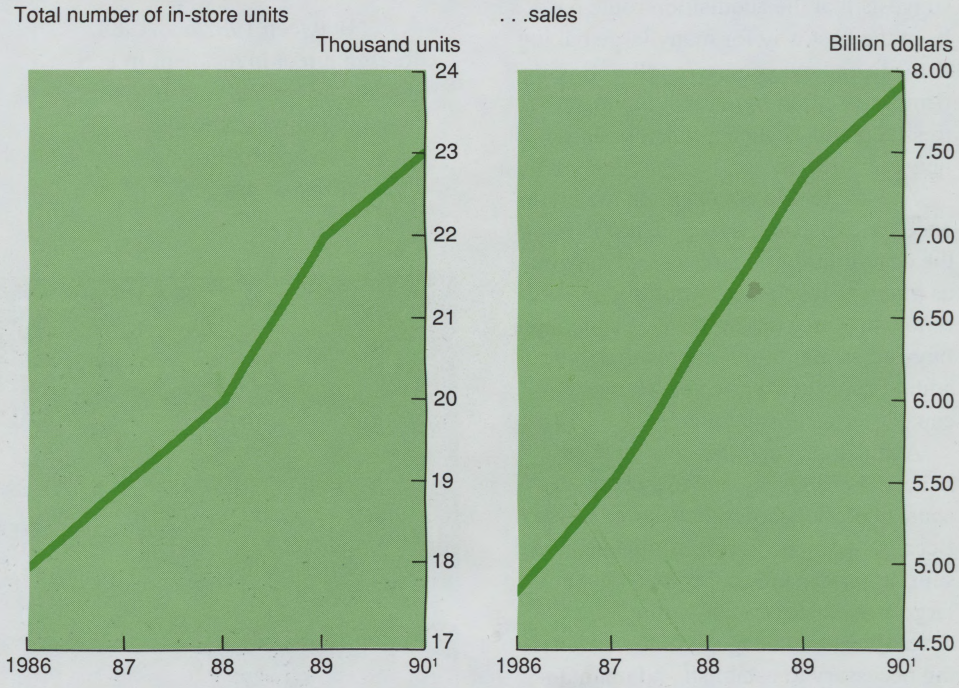
Most importantly, wholesalers often supply in-store bakeries with frozen dough. Lacking experienced scratch bakers, many in-store bakery operators depend on the frozen dough provided by wholesalers that is later "baked off" and sold as fresh. Over three-quarters of all in-store bakeries in the late 1980's sold bake-off production, either solely or in combination with scratch-mix products.

Table 3. Winn-Dixie Ranked Number 1 in 1990 Among Supermarkets with In-store Bakeries

Rank	Supermarket company	Number of in-store bakeries
1	Winn-Dixie Stores, Inc.	1,117
2	Kroger Food Stores	946
3	Great A&P Food Stores	716
4	Safeway Stores, Inc.	575
5	American Stores Companies	513
6	Albertson's, Inc.	447
7	Publix Supermarkets, Inc.	336
8	Food Lion, Inc.	255
9	Grand Union, Inc.	155
10	Vons Companies, Inc.	154

Source: "In-store Top 50." *Bakery Production and Marketing,* March 24, 1991, p. 103.

Figure 2. In-Store Bakery Growth May Be Slowing



[1]Estimate.
Source: "Trends '90," *Bakery Production and Marketing,* June 24, 1990, p. 60.

New Product Introductions Are Costly

Intensifying competition in baking has disadvantaged many small, single-plant operations. These firms do not have the capital base to invest heavily in new product development and national advertising campaigns. Retailers often succumb to the "muscle" of major companies in introducing new products because their goods, backed by heavy advertising and name recognition, have a higher chance of selling than those of small bakers.

Growing product proliferation has heightened competition. In the late 1980's, over 12,000 new items in total were introduced each year, more than double the number of the early 1980's. The costs of new product introductions are large, and major companies are often better able to finance them.

Manufacturers and retailers have always negotiated the costs of introducing a new product. Manufacturers often use trade deals and allowances to encourage favorable treatment by supermarkets. As an example, manufacturers frequently pay supermarket chains an advertising allowance to guarantee inclusion of their product in the chain's newspaper ads.

With growing product proliferation, retailers appear to be increasing their weight in the balance of power with manufacturers. "Slotting fees," a term defined in the late 1980's, take the notion of trade deals and allowances a step further. Some retailers have charged prices ranging from $15,000 to $40,000 per product per store to cover the costs of stocking selected new items. Manufacturers might pay $2-3 million nationally in slotting fees to introduce a new product in stores across the country.

Slotting fees depend largely on the balance of power between the retailer and the manufacturer, the expected popularity of a new product, and the new product's uniqueness. In addition, slotting fees are likely higher in markets where a few retailers hold a large share of the market than in those that are less concentrated. If a retailer with a small market share tried to charge a large slotting fee for a popular new product, that retailer might find itself lacking an item that consumers are constantly requesting.

Because of the proliferation of new products and the incidence of failures, some retailers are also thinking about charging "failure fees." Failure fees insulate retailers from the costs of removing failed new products from the distribution system. With their sophisticated scanning equipment, retailers have thorough knowledge of item sales and how well new products perform.

Industry Task Force Study

Key costs for product introductions include research and development, market analysis, trade deals and allowances, and product advertising and promotion. A recent Joint Industry Task Force of the Food Marketing Institute and Grocery Manufacturers of America found that the cost per stock keeping unit (SKU) of introducing a new grocery product in 1988 ranged from $378,000 to $21.2 million, and averaged $5.1 million.

Manufacturers who bear most of the costs of product introductions can save considerable expense by introducing more than one product at a time. For example, a manufacturer may spend $3 million on advertising for a line of new products, rather than just for one item.

Many new products quickly become failures. For failed new products, key costs include product deletion throughout the store, warehouse, and distribution channels; disposal of raw materials and finished goods; and product markdowns. Retailers bear the primary costs of product failures. The Joint Industry Task Force reported that the average retailer cost per SKU per store for a product deletion was $10.77, versus $3.94 for manufacturers and $1.60 for wholesalers. Because of these large costs, some retailers have thought about charging "failure fees."

Outlets Fill Market Niches

The growth in retail bakeries has also heightened competition. Retail bakers, often franchisees, tend to do well in shopping malls, near commuter stations, and in business districts. They vary from multi-unit enterprises to "mom and pop" stores, and from full-line bakeries to specialty cookie shops. Overall, the number of retail bakeries grew from about 16,000 in 1981 to 23,000 in 1990—a 44-percent increase in less than a decade. In 1990, retail bakeries did about $5.7 billion in business, slightly higher than 1989.

Bread loaves, fresh out of the ovens, are checked for quality. Photo credit: Continental Baking Company

Foodservice outlets have also sharpened industry competition. These outlets sell large quantities of sandwiches, with breads, buns, and rolls a major component, and run the gamut from fast-food units to up-scale cafes. *Bakery Production and Marketing* magazine estimates that foodservice bakery sales (from those baking on-premise or receiving products from dedicated commissaries) were $8.7 billion in 1990, an increase of 5 percent over the previous year.

Foodservice outlets pose a special challenge to other types of bakery merchandisers. Sandwich breads and rolls are a favorite of consumers at rapidly growing take-out restaurants. This is because sandwiches are easy to handle, quickly prepared, fairly inexpensive, and perceived as "light fare." As evidence of this market's growth, a National Restaurant Association survey of 50 menus found that the number of sandwiches listed jumped 55 percent between 1984 and 1989.

Competition from take-out restaurants has concerned many supermarket chains and bakery operators. One trade magazine reports that the turf battles over take-out have become so intense that "both supermarket and foodservice operators publicly complain that they perceive each other as threats."

In an industry shifting its focus from selling quantity to providing variety, small baking companies—whether wholesalers or retailers—must seek out narrow market niches. Providing distinctive products will probably enhance the profitability of both small operations and large national companies.

Innovative Strategies Expand Markets

With the growth of industry competition, bakery operators increasingly use new marketing approaches and production methods. Bakers are borrowing ideas from other industry segments, tailoring them to their own requirements. As a result, delineations between wholesalers and retailers have become much less rigid.

Cookie and cracker companies are not as constrained by product perishability as bread and cake firms, so they have fewer plants and a more national focus.
Photo credit: Nabisco Brands, Inc.

Examples of innovative strategies abound. For instance, T.J. Cinnamons and Mrs. Fields, two large retail bakery chains, are selling their products at in-store supermarket bakeries. Eagle Food Centers, which operates 83 in-store bakeries, has been test-marketing dessert cakes from a Chicago-area retailer. Some specialty cookie bakers are offering the option of mail-order purchases.

Recently, an important growth strategy involves the "natural" food product area. In response to consumer demand for high-fiber products, bakers tapped into the "oat-bran craze." Scientific evidence has wavered about the health benefits of oats, but the latest studies offer evidence that oat products may indeed lower cholesterol. The focus is also on "lite" (low-calorie) breads and "low salt" crackers. New fat substitutes and formulas that eliminate fats have spawned a tide of "no-fat, no-cholesterol" products.

However, manufacturers recently have been made aware of the limits to "healthful" advertising. In early September 1990, the Food and Drug Administration (FDA) warned several companies about health claims for their products (including baked goods) that linked oat bran to cholesterol reduction. FDA stated that there was not enough fiber in the products to justify the claims that the companies had made at that time.

Challenges Ahead

Like other food industries, the baking industry currently faces recessionary pressures. If the recession is prolonged, consumers will likely focus more on the basics than on premium, up-scale items. This reaction translates into an emphasis on private label baked goods, rather than branded, high-ticket products. Brand loyalty could diminish as consumers search for bargains.

Baking companies are using different strategies to deal with the recession. Some are cutting routes and employees, delaying major capital expenditures and shortening work hours.

Those companies with low debts and marketing muscle may be better able to take advantage of the situation. These firms may look to weaker competitors as acquisition targets, hire talented personnel who were laid off by competitors, and make major capital purchases from anxious equipment vendors. Most enterprises will target better performance, and bakers may heavily discount their products to keep ovens busy.

Bakers also feel squeezed by environmental concerns. One recent target has been the smog-producing ethyl alcohol released during the leavening process. By unanimous vote on January 1991, Southern California's South Coast Air Quality Management District Board ordered 24 large commercial bakeries to install smog controls on their ovens. According to the *Washington Post,* the 72 ovens produced almost as much smog as a single oil refinery.

An image of excess packaging poses another potential environmental problem for bakers. Plastic or aluminum foil packaging prevents spoilage of baked goods *(see box "Modified Atmosphere Packaging Extends Shelf Life")*. To help combat consumer doubts about excess packaging, programs are emerging to recycle bakery wrappers. ■

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Modified Atmosphere Packaging Extends Shelf Life

Bakers are starting to use modified atmosphere packaging (MAP), a technology to extend shelf life up to 30 days and freezer life up to 6 months. MAP is a natural process. The technology replaces air by vacuum packing nitrogen or carbon dioxide inside the package and does not require the use of additives or preservatives to prevent spoilage.

MAP offers several advantages. Because it extends shelf life, MAP gives retailers a longer time to sell the product. It allows retailers to stock slower moving products that they might not offer otherwise. Bakers can also gain by mass producing slow-selling items or building inventories of fast-selling items.

Image and cost remain the two drawbacks to MAP bakery products. Retailers wonder if consumers will perceive a product with a 30-day shelf life as "fresh baked." Such goods could reflect negatively on the whole bakery department. Also, MAP items are sometimes more expensive. But if a bakery is already packaging a product, the cost of MAP can add as little as one-tenth of a cent per packaged item.