Monitoring the Impact of Consolidation in the Food System on the Consumer in 1996

Anthony E. Gallo

Very little research has been done on the impact of mergers, divestitures, and leveraged buyouts on the American consumer. The U.S. food marketing system had nearly 400 mergers and leveraged buyouts in 1996, bringing the 15-year total to about 6,400. In 1996, all indicators show that consumers were not adversely affected by this level of activity, although profitability and owners' equity continue to skyrocket. This presentation examines the consumer's welfare indirectly by looking at key economic indicators of the food marketing system in 1996 — such as retail food prices, advertising expenditures, new product introductions, research and development, profitability, and equity appreciation.

The U.S. food marketing system — consisting of food processors, wholesalers, retailers, and foodservice firms — underwent over 6,400 mergers, acquisitions, and leveraged buyouts between 1982 and 1996. Consolidation had led to greater concentration in all four sectors of the U.S. food system. But how has the consumer been affected by this consolidation? Does consolidation lead to higher or lower food price, quality, and quantity? Has increased consolidation and concentration led to excess profits and inordinate increases in stockholders' net worth at the expense of consumer passthroughs?

The purpose of this presentation is to assess the impact of consolidation in the system following years of intense merger activity. Changes in the efficiency of the food marketing system — such as changes in productivity, management efficiency, labor costs, entry of new firms, innovation, and research and development — can have a longer-term impact on consumer prices and choices.

The Paradigm of the Food System

Merger and acquisition activity, both in value and number of transactions, is continuing strongly in the 1990's, but is nowhere near the level of the late 1980's. In 1996, there were 399 mergers, divestitures, or leveraged buyout transactions (fig. 1). More than 60 percent of all these activities (210) were in food processing, while the remainder were in food retailing (37), food wholesaling (32), and food service (120). These food marketing mergers and leveraged buyouts were valued at about $8 billion in 1996 alone (fig. 2).

Figure 1. Food marketing mergers and acquisitions, 1982-96.

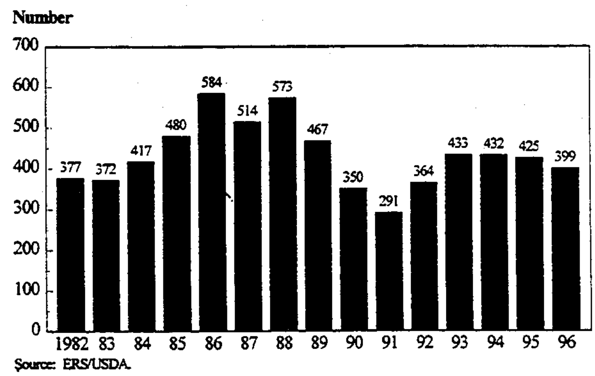
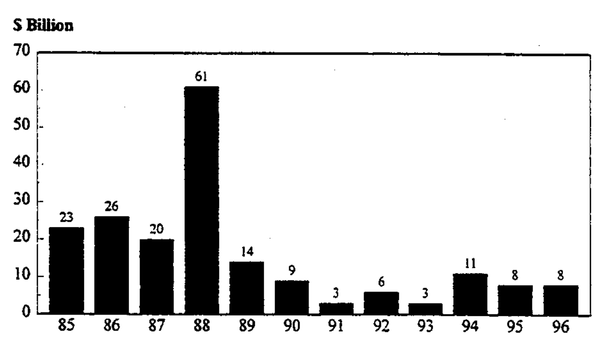


Figure 2. Value of food marketing mergers and leveraged buyouts costing more than $100 million, 1985-96.



Anthony Gallo is Senior Economist and Coordinator, Food Marketing Review, Economic Research Service, US Department of Agriculture.

In food processing, concentration among the top 100 firms appears to have risen sharply between 1982 and 1996. The 100 largest food and tobacco manufacturing companies accounted for about 35 percent of value added in 1982: by 1996, this share had risen to 55 percent.

In the 1997 Food Distribution Research Society report, we looked at the impact of this change on the conduct and performance of the food economy (Gallo). We found at that time that:

• Despite this vast transaction activity, consumer prices for food had not increased appreciably. Between 1982 and 1995, retail food prices as measured by the Consumer Price Index (CPI) rose 54 percent, about the same as the increase in the overall CPI. By contrast, medical costs rose 120 percent and housing costs rose 66 percent. Changes in retail food prices by product did not show any increase that could be associated with consolidations in particular food processing industries.

• Competition appeared strong at the food manufacturing level as witnessed by rapid product introduction and rampant advertising. Advertising is a major form of nonprice competition, and expenditures appear unchecked. Food is still the largest advertiser in the American economy. For most food processing industries, the three largest advertisers account for the great bulk of all advertising. As expected, the most concentrated industries — including breakfast cereals, beer, wine, liquor, and prepared and convenience foods — account for most of the advertising. New product introductions appeared to have been unaffected by consolidations, escalating to nearly 17,000 in 1995. Since the consolidation mania began in the early 1980's, over 150,000 new grocery products have been introduced, many within the last 5 years.

• Plant and equipment and research and development expenditures continued strong. From 1985 to 1995, between 300 and 400 new food processing plants were completed each year. Food processing is one of the nation's most automated industries, and consolidation has been accompanied by much capital expansion. Research and development appears to have been unaffected by consolidation. Food processing firms have traditionally allocated about 0.5 percent of sales to research and development, and this figure has remained unchanged in recent years. Meanwhile, output per man-hour in the food processing system overall continues to increase; according to a recent study by the Census Bureau, output per man-hour increased in plants of merged firms even more rapidly.

• The food marketing system has the highest profitability and stockholders' equity of all sectors and profitability continues to rise sharply. Not only are profits from domestic and foreign operations up sharply, but leveraging has given new impetus to higher profit rates. After-tax profits as a percentage of stockholders' equity, for both food processors and retailers, are above those for all manufacturing and retailing. The owners of food marketing firms have prospered during these merger years, in part due to consolidation. Between 1982 and 1995, the Dow-Jones equity market indexes showed a nearly five-fold increase. For the same period, the equity index for food multiplied nearly 11 times, beverages 15.

Conduct and Performance in 1996

Key indicators in 1996 show that the consumer continues to benefit from food marketing consolidations. Despite the consolidation and increased concentration in all four sectors of the food marketing system, competition continued strong. Competition is an extremely difficult measure to assess, but we look at three basic measures: retail pricing, advertising, and new product introductions. These indicate consumer welfare by measuring product pricing, product choice, and availability. Other points of interest include:

• Retail grocery prices rose a moderate 3.7 percent in 1996, while food away from home rose 2.5 percent, roughly in line with the rise for all consumer goods. Marketing margins continued to stay in line.

• Two other forms of nonprice competition showed vigorous competition among food processing companies. Advertising expenditures rose from $10.2 billion in 1995 to $12 billion in 1996, as food processors, retailers, and fast-food chains continue as the largest advertisers in the U.S. economy. In addition, over 13,000 new food products were introduced in 1996, off from the previous year's total of 15,000.

• The number of new food processing plants rose to 485 in 1996, an all-time high. Nearly $20 billion was spent constructing these plants. Expenditures on research and development also rose, to about $2 billion.

Table 1. Impact of food system consolidation on the American consumer in 1996.

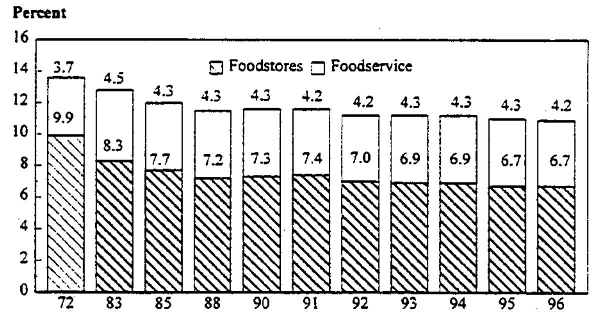
Indicator	Change
Retail Price Increase	Moderate
Advertising	Up Sharply
New Product Introductions	Down but Only an Aberration
Research and Development	Same
New Plant	Up Sharply
Profitability	Up Sharply
Owners Equity	Up Sharply

• Output per employee rose in most food manufacturing industries in 1996, although final data are not yet available.

• Profitability and owners' equity were up sharply again. The question of excess profits because of increased concentration arises perennially. The food marketing system is extremely profitable. Food manufacturers earned nearly 20 percent on stockholders' equity, considerably above the 17-percent return for all nondurable companies. The 17.5 percent return for all food retailers was the highest in all retailing.

• Despite the higher profitability afforded stockholders, consumers continue to gain in terms of share of income allocated to food. The share fell to 10.9 percent in 1996, the lowest in U.S. history (Figure 3).

Figure 3. Food marketing system's share of disposable personal income.



Source: ERS/USDA.

More Intense Price Examination and Conclusions

The next phase of this monitoring effort involves the use of Nielsen data, which contains sales of all grocery products by stores with sales of $2 million or more. This method enables each product to be examined for price changes on a firm-by-firm basis following mergers. Preliminary indications are that prices for most items have in fact declined following mergers.

Nearly all measures show that the food marketing system continues to do very well following consolidation. These measures include leveraging, profitability, capital expansion, appreciation, research and development, productivity, and performance in international markets. While an examination of the aggregate indicators shows that consumers have benefited, an examination of price movements following the mergers of the last 15 years using Nielsen data should show definitively whether consumers are paying more or less in retail prices.

References

Gallo, Anthony E. "Consolidation in the U.S. Food Marketing System." *Journal of Food Distribution Research*, 28:3, (February 1997), pgs. 30-35,

Gallo, Anthony E. et. al., *Food Marketing System in 1995*, AIB 731 Economic Research Service, U.S. Department of Agriculture, December 1996.

The Food Institute Report.