AREADEVELOPMENT

A Changing Food Manufacturing Industry

Evolving consumer preferences, the use of automation, food safety regulations, and foreign direct investment are stirring up the food industry.

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Food manufacturing and processing, like nearly all manufacturing segments, is undergoing change. A report by A.T. Kearney and The Hartman Group released in August of 2016 titled Is Big Food in Trouble? revealed some of the challenges facing the food business. One key trend the survey uncovered is a slowing of the growth of the largest food and beverage companies.

The top 25 U.S. food manufacturers have ceded 300 basis points to small and medium-sized competitors since 2012, and have grown revenue at 1.8 percent compared with 11 to 15 percent growth for smaller companies. The report cited several factors contributing to this, including changes in consumers' core values — amplified by social media, celebrity chefs, and myriad food-as-nutrition experts — that are rewarding small and medium-size companies with above-average growth and slowing the growth of the top 25 food and beverage companies.

According to Shelley Balanko, Ph.D., senior vice president of The Hartman Group, "Smaller, younger food/beverage producers appear to have a better understanding of consumers' contemporary definitions of food/beverage quality — for example, fresh, health cues, culinary values, transparency. They also appear to be targeting niche premium benefits that resonate better with today's consumers who perceive their needs as ever more unique and, therefore, seek highly personalized and/or customized food/beverage experiences," Balanko told Area Development. The larger food processors have made some attempts to catch up to the trends of today's consumers, by "renovating products, innovating, and /or acquiring small brands that are more on-trend," Balanko added.

Dave Donnan, partner with A.T. Kearney, explained to Area Development three factors he considers most interesting in the study: First, he notes the size of the drop in market share experienced by the big companies. "The top 25 food companies have lost over $15 billion in market share…And it's not just companies that are losing share, but product categories are dropping as well. Some iconic brands are doing well — but a lot of categories such as dry breakfast cereal have declined quite a lot."

{{RELATEDLINKS}} That is the second-largest trend the A.T. Kearney study found. "People are buying more in the perimeter area such as the deli, prepared foods, meat, and dairy as they seek fresher and healthier eating; center aisles where you find dry and packaged goods are experiencing losses," he explained.

Third, Donnan commented that store brands are growing as well, "as retailers start to put higher quality and better-for-you products on shelves" that compete with long-time familiar brands. Kroger, for example, has the higher quality brand in many areas, and Costco's Kirkland brand is one many consider better overall than known brands, Donnan noted.

Structural Changes in Food Manufacturing:
In a report from Food Engineering, 2017 State of Food Manufacturing Survey, 10 top trends were noted that are affecting the future of food manufacturing. Structural changes cited by survey respondents included changed a process (39 percent), added manufacturing staff (33 percent), and added a new line (30 percent), and expanded/renovated/added capacity to existing plants (30 percent). Overall, reported Food Engineering, food manufacturing is "generally in good shape," as shown by the survey responses: "About half of the respondents report throughput is up at their plant locations, as well as their companies, and is expected to grow in 2017."

Surveys generally show that plant expansions are outpacing consolidation. In the Food Engineering survey, 7 percent of the respondents reported building a new plant, while 5 percent have consolidated manufacturing facilities.

Mark Redmond, president of Food Plant Engineering, a Cincinnati-based company that designs plants for food processing, said increased demand is certainly a major factor driving this increase in business, but Food Engineering reports that "a number of respondents say the growth is coming from their companies finding new efficiencies in production." Much of this can be attributed to increased use of automation, something that Food Engineering calls "the most impactful trend" to affect manufacturing operations over the next five years — ranking this #1 among the 10 top trends.

Food Engineering's 40th Annual Plant Construction Survey (June 2017), "found there is a concern that many plants might not be able to reach FSMA (Food Safety Modernization Act) compliancy." However, many co-manufacturers and co-packers "have invested in food safety and are seeing their best pay off through fulfilling more orders from big brand names."

All three countries in the North American Free Trade Agreement rely heavily on exports across borders. Additionally, M&A activity in the food manufacturing sector has generally been strong, as A.T. Kearney's Donnan points out: "Several big deals have been done such as the Kraft/Heinz deal and Tyson buying Hillshire Farms." He adds, "A lot of the large food companies might buy for cost synergies, but many look for acquisitions in growing categories."

A.T. Kearney reported that through these types of acquisitions large companies "can expand in premium market tiers by acquiring natural, organic, and 'free from' products that command higher prices from consumers willing to pay more for healthier offerings. Acquirers also can reap value by capturing merger synergies through zero-based budgeting and optimization of networks, sourcing, and assortments."

Foreign Investments in U.S. Plants
Capital investment by foreign companies in the U.S. is also driving U.S. growth in the food and beverage industry. According to a report from the U.S. Department of Commerce's Bureau of Economic Analysis, foreign direct investment (FDI) in the processed food industry across North America translates into additional sales of U.S. agricultural products, further supporting American jobs. In 2012, majority-owned affiliates of U.S. multinational food companies had sales of $32.4 billion in Canada and $13.8 billion in Mexico.

When Mexico-based La Moderna located its first U.S. plant in Cleburne, Texas, a lot of people in the Hispanic communities recognized this iconic brand. The maker of pasta, pastries, and whole wheat flour was already shipping 4,000 tons of its products from Mexico to the U.S. every month, but the company's $35 million Cleburne plant was projected to supply 3,500 tons per month.

Mexican firm Sesajal announced in July 2017 the acquisition of a majority stake in U.S.-based Chosen Foods of San Diego. The company is a leading processor of specialty oils. “The deal is expected to combine a fast-growing brand in North America with a better-for-you food manufacturing company from Mexico,” said George Todd, director of Chosen Foods. “Sesajal has been a valuable partner for the company for many years.”

People are buying more in the perimeter area such as the deli, prepared foods, meat, and dairy as they seek fresher and healthier eating; center aisles where you find dry and packaged goods are experiencing losses. Dave Donnan, partner, A.T. Kearney Grupo Bimbo, the “world’s largest bread maker” according to the company, and the “biggest bread seller in the U.S.,” has been investing in the U.S. market for more than 20 years. The company’s first acquisition in the U.S. was in 1994 when it bought La Hacienda Tortilla Company. Known today as Bimbo Bakers USA, the company’s headquarters are in Horsham, Pa. The company owns brands such as Boboli, Entenmann’s, Orowheat, Thomas’ and, in 2011, purchased Sara Lee’s North American Fresh Bakery brand. The company’s most recent acquisition was announced in July of this year — East Balt Bakeries founded in 1955 in Chicago, which produces and supplies bagels, biscuits, English muffins, tortillas, and breads in the U.S., Europe, Asia, the Middle East, and Africa. Grupo Bimbo reportedly paid $650 million for East Balt.

The largest merger for 2016 was Danone’s acquisition of WhiteWave Foods Co. for $12.5 billion, which doubles the size of the French company’s U.S. business — which has been renamed DanoneWave.

NAFTA Renegotiation and Food Processors

Food and agriculture are big business across the North American continent as all three countries in the North American Free Trade Agreement rely heavily on exports across borders. According to the U.S. Department of Agriculture (USDA), the North American market has become a “bonanza for U.S. farmers and ranchers over the past 20 years,” with one in every 10 acres planted on American farms feeding Canadians and Mexicans.

Based on a USDA estimate, for every $1 of food and agricultural exports, another $1.27 is generated in business activity. That is, in 2016 U.S. food and agricultural exports to Mexico and Canada supported $54.6 billion in additional business activity. “In the 20 years since NAFTA was initiated, U.S. food and agriculture has grown to support hundreds of thousands of good jobs, support U.S. food security, improved efficiency and innovation, and enhanced our competitiveness in a rapidly changing global economy,” said the report.

It is believed by many that NAFTA renegotiation could jeopardize U.S. food processors access to Canadian products. According to Dr. Al Mussell, Research Lead of Agri-Food Economic Systems in a report for Farmscape, a Canadian publication, “Processors need to be sensitive to the potential impact on them of reduced access to imported Canadian products under a renegotiation of NAFTA.” Mussell “observes the U.S. food processing industry has benefitted from imports of Canadian bulk products, primarily grain, and intermediate imports such as ground grain and livestock.”

In a startling comment, Mussell said, “I think the reality is the U.S. wouldn’t be able to support its food processing industries at the level they’ve been able to had they not had access to Canadian products.” He gave an example of oats that the U.S. imports from Manitoba “directly down into breakfast cereal manufacturing plants in the United States. The U.S. is not a large oat producer of its own. Whether or not it could sustain those kinds of industries, understanding that oats are a big part of what goes into breakfast cereal, is perhaps on open question, but probably pretty difficult for them without access to Canada.”

The same holds true for pork products and red meat products, Mussell noted. “We know the U.S. imports a significant volume of Canadian cattle and hogs for processing in their plants and products, which they turn around and export back to Canada as well as elsewhere as ready-to-eat products. That’s the value added that’s added in the U.S.”

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