The Bakery Market - a Retailer's View

Kevin Hawkins

Quotations

I will start with three quotations which between them highlight some current issues in the baking industry.

The first is from Paul Wilkinson, who recently described his retail customers as a cross the industry has to bear.

The second is from Prof. Paul Dobson, well-known for his anti-retailer perspective, who argues that below cost selling is a big problem for the industry.

And the third one from Simon Foster who, more constructively, suggests that the consumer can be won over if we do the right things

I'll touch on all these issues in the next few minutes.

Issues

So what's happening out there in the market place?

What's our strategy – and when I say 'our', I mean Safeway's

And will the bakery market and the bakery industry look like in 5 or 10 years time?

Let's fist put the bakery market in context. Our eating habits as a nation have been changing over the past 20-odd years and this has had a big impact on the food industry and agriculture as a whole.

Taking the last 10 years:

Changes in household food consumption

Looking at these broad groups of foods, we can see that fruit has been the big winner – up 25% on the decade.

Cereals including bakery have seen a bit of growth but not too much

Meat and fish are static

Milk is down a bit

As are vegetables

But the big losers are eggs, fats and oils, fresh potatoes and sugar

Now if we look at what's happening within these food groups, some very interesting trends emerge.

Consumption changes within food groups

In meat, there's been a big fall in carcase meat consumption because we're all eating fewer joints, chops and the like

But meat products, including meat-based ready meals, are growing quite strongly.

And cooked chicken has done outstandingly well

In fruit, the big winners have been grapes, bananas and juice, - largely because they're convenient, easy to eat and fashionable

By contrast, traditional stone fruits are declining

In vegetables, potato products like crisps and chips have done well, as have mushrooms and salads, but fresh greens are declining

Consumption changes (cont'd)

In the cereals and bakery sector, cakes, buns, scones, chocolate biscuits have all increased by 26%, whereas bread is down 10%, and as an ingredient flour has fallen by 36%. The real winner, however, is fresh pasta, with 43% growth in the two years from 1998 alone.

And finally in dairy products, there's been a big switch to semi-skimmed milk, which hasn't been enough to stop the long-term fall in milk consumption. Cheese is static, but yoghurt and the like are growing strongly.

Domestic Bread Consumption

This chart track the consumption of four main groups of bread products over 10 years.

White looks broadly stable

But all the others are n decline

However, there are some interesting variations within these groups, which we'll look at in a moment.

Domestic Consumption of Cake and Biscuits

This tells a different story, with all three categories showing good growth over the decade.

UK Retail Value of Bread by Source, 1996-2000

Focusing on bread and taking the period 1996-2000, both plant bread and ISB increased their share of the market at the expense of the craft sector, with ISB growing a bit faster than plant. But, by the value, the whole market grew by 6%.

Unfortunately, we don't yet have up to date figures for 2000-2002 from Mintel covering the whole market. But from TNS, we have data covering the sales of the top 4 retailers.

Multiples: Bread Volume Sales 2000-2002

First, in volume terms, plant sales fell very slightly

White sales generally were marginally down, but within the white category premium white showed strong growth at 52% while standard white fell 15% and value white – the economy lines – declined by 45%.

This group of speciality breads grew slightly, although within it dietary products grew very well and Long Life fell back.

Brown fell by 7%

And ISB sales retreated by 18%, reflecting the strong up trend in plant bread sales.

Top 4 Multiples: Bread Value Sales, 2000-2002

A rather different picture emerges here, which reflects the impact of price inflation on sales.

Total plant increased by 12%

The white category was up by nearly 18%

While both standard white and, more especially, value white declined

The speciality group was up by 5%, again driven primarily by the dietary ranges

While brown was virtually unchanged

And ISB was down 14%

Top 4 Multiples: Other Bakery Products by Volume 2000-2002

Looking at other bakery products, the picture is generally positive. Volume sales of most categories increased with particularly strong growth from Breads of the World. (23%up).

Top 4 Multiples: Other Bakery Products by Value 2000-2002

By value, the growth picture is generally stronger, again reflecting some price inflation, with another strong performance from breads of the world (28% up).

So what's driving these changes?

Market Drivers

Bakery is obviously being affected by the general trend towards more convenience eating – particularly fast food eaten as snacks in place of traditional cooked meals.

One example of this is the growth in breakfast cereals over the past decade. In 2000, average consumption of breakfast cereals per person per week was 143 grammes, compared with 127 grammes in 1990. Cereals have tended to push bread out as the main breakfast food, especially in higher income households.

But what about the sandwich market? Isn't this helping bread sales? Yes and No.

Sandwiches

Over half of all sandwiches are still made and eaten at home

27% are made at home and eaten somewhere else – this is largely the kid's lunchbox. With the decline in school meals, most children now take sandwiches to school.

Only 17% are bought in a retail outlet

The market itself is now worth over £3 billion.

And it's growing by a steady 7 to 8% a year

The multiples have around a third of the market by value

Hot sandwiches to take away are the latest growth area but they are still only 5% of the market.

There's a bias among sandwich eaters towards ABC1 consumers

And it's estimated that three quarters of adults now regularly eat sandwiches at lunchtime. Not necessarily every day – but often enough

Foods most commonly eaten as snacks (insert)

However, as you can see from this slide, bread and sandwiches are well down the list of the most popular snacking foods. Fruit, chocolate, biscuits cakes and crisps are well ahead.

Product innovation – you can see from the slides I showed earlier that premium and speciality products are growing rapidly. This trend is evident in other sectors of the good industry. It reflects the demand for something different, something new, something easy and convenient to eat and it's a demand which is less and less price conscious provided these other, non-price expectations are met.

And, finally, we have all the efforts which the two big manufactures have put into developing their premium brands – for example, the Whole White Loaf and the re-launch of Hovis – plus a big increase in advertising activity. All this has certainly helped derived the market forward.

Safeway's Strategy

Our goal for our bakery range is in line with out vision for fresh foods generally. It is to be the first choice baker locally, with industry-leading standards of innovation, service and skills.

ISB is our priority for growth. We are now the second biggest player in the ISB sector with a 17.2% share – up from 14% 18 months ago. Although ISB generally is declining, we're bucking the trend and we're currently doing 6% year on year sales growth. We now have 4000 ISBs each employing on average 6 bakers. If you assume that our three larger competitors employ at least as many, between us we employ over 10 000 skilled bakers – which more than makes up for the decline of the independents over the same timescale and maintains the skill base of the bakery industry.

We've focusing on ISB because it's the only way we can differentiate our offer from the big brands. Plant bread will always have a big role to play in our offer and, as a company, we're driving a gradual switch among our customers from our own-brand to the manufacturers' brands because the transaction value per loaf is higher. Other retailers, however, have different priorities.

One area of innovation in our ISB range is our growing range of local and regional bread. We launches this in East Anglia earlier this year using flour milled from grain supplied y a farmer's co-operative. We've recently extended this range to Wessex, Cotswold, Mid Shires and North Shires. All these regional breads use flour drawn from a small number of farms within those regions. Customer reaction has been very good to date and we think there's a lot more mileage in this market.

Breads of the World is also a big success for us – we launched it 2 years ago and we're currently achieving 20% growth year on year.

In the cakes, buns, cookies sector we're achieving 11% growth year on year, and here we've seen very little product innovation from the plant bakers.

The in-store environment is a critical part of our strategy. Over the past year we've refitted over 30% of our selling space in a new format with a much bigger emphasis on fresh to go. Bakery is an important part of this investment programme.

Turning now to a more contentious issue – the price o bread. Is it too cheap? Comparisons by the Competitions Commission suggest that in the late 1990's bread and cereal products generally were significantly cheaper in the UK than in France, Germany and the Netherlands, although the gap was narrowing. But is would question the basis on which the Commission came to this conclusion. They quoted the price of a sliced white loaf (800g) as 22p for the UK, compared with 42p in France and 61p in Germany. Well, 22p may be accurate for a value line but these lines are a small and declining proportion of total bread sales. So is bread really too cheap? And if it is, will it continue to be?

Is Bread too cheap?

The structure of any industry usually influences the level and behaviour of prices because it shapes the kind of competition you have. This is an industry which is domination by three major manufacturers and their big brands. The concentration goes back u the supply chain to milling, where the top 3 millers account for 60% of the volume. Scale economies are obviously critical. In fact Paul Wilkinson predicts that within the next few years the brands will increase their market share to 75%, that the independents will merge their own-label plant bread business into one company to get scale economies, and all the major bakeries will be vertically integrated.

If this is the case, then one would expect average prices to rise as consumers switch out of own-label lines into premium branded lines, which as I said a moment ago, we in Safeway are encouraging. One would also expect to see an improving trend in the profitability of the big bakers as their cost base reduces and the sales mix moves in their favour

Second, there is the problem of the value lines which tend to be sold at 2 or 3 pence below cost. Not, I hasten to add, by Safeway. We're currently selling ours at cost. But if this category is

declining – which it certainly is – what's the problem. The argument, presumably, is that the very existence of this category tends to hold down the price of higher grades of bread and therefore keeps the industry profits lower than they would otherwise be. I don't buy this argument. There's a very wide range of prices in any supermarket bread offer – from the value line at one end to the ISB speciality product at the other. The growing share of the premium brands and the speciality breads shows that consumers vote with their feet. The effect of the value lines has been greatly exaggerated and whatever it amounted to in the past , it's now obviously declining.

For the same reason, I don't believe that the value lines have had much if any influence on the continuing demise of the independent retailer. This decline started long before below cost selling appeared and is driven by a range of different factors. It's also not peculiar to independent bakers and extends to virtually every other sector of retailing, regardless of whether below cost selling exists in those sectors or not.

Nor do I think that this has been a major factor in driving small producers out of the industry. As with small retailer, small producers through the food industry are finding it more and more difficult to compete in the same markets against much bigger rivals who have sale economies and big brands. Increasingly the choice is to specialise, do something different, or merge into a larger unit.

The claim from Prof. Dobson and others is that below cost selling has cheapened the product in the eyes of the consumer and made it necessary for the big manufacturers to invest heavily in new products and advertising to raise consumer interest. But there's nothing unique about the bakery industry in this respect. In every other sector of the food industry, sales growth depends on product innovation and promotional investment. In a mature market, like bread, you need to do something new to stimulate consumer interest. And the manufacturers are doing it – successfully – thereby disproving Dobson's claim that the product has been devalued by the retailers.

So should below cost selling be prohibited by law?

Should Below-Cost selling be prohibited?

Well first we have to distinguish between promotional selling below cost – which we in Safeway do every week on about 80 big volume lines across the range.

The Competition Commission had no objection to this type of activity. The other type, of course is persistent selling below cost, which the commission didn't like.

Its main concerns were that persistent below cost selling enables bit retailers to cross-subsidise and this distorts competition at the expense of smaller retailers, especially in the convenience sector. To the extend that this has helped drive smaller retailers out of business, the Commission said it was against the public interest.

But the Commission didn't see any particular remedy that would work. They looked at the experience of France and Ireland, both of which banned persistent below-cost selling, and found that the ban had reduced competition and increased margins.

They recognised that there would be problems of identifying those products persistently sold below cost, that there would have to be exceptions for promotions, that the big multiples could circumvent any ban by forcing suppliers to reduce their supply cost to a level which would allow retailers to go on charging very low prices. So the net result of a prohibition might be widespread evasion and, where it was effective, higher prices to consumers.

This brings us to the final point, which is to comment on Paul Wilkinson's 'cross we have to bear' description of his major customers.

Are the Multiples too powerful?

Competition commission crawled over our books for 18months and concluded that the bit retailers are broadly competitive and don't make excessive profits. The average net margin to sales of the top 6 retailers is around 5%. By comparison, the average net margin for the top ten food manufacturers is nearly double that.

But the Commission was concerned about the power of the big multiples over suppliers – especially the smaller suppliers. It didn't really consider our relations with the bit international manufacturers with power brands which we are obliged to sell – and, incidentally, sell on their terms not on ours.

The Commission identified 30 trading practices which it said were against the public interest and decided that the best way of tackling this was to impose a legally binding Code of Practice on the top 4 retailers.

From the suppliers' point of view, however, the problems with the Code are that it only covers the top 4 – no one else. But if you're a farmer, you don't supply a retailer direct, you supply a processor. And the processors aren't covered by the Code.

Also the code doesn't formally prohibit most of these practices. It simply imposes a reasonableness test on the retailers – reasonableness being determined by things like giving proper notice of contractual changes, agreeing everything up front etc.

So, not surprisingly, 6 months after the Code was launched, suppliers large and small are saying it's a waste of time and hasn't changed anything. Whether the Government will recognise these concerns in it's forthcoming response to the Curry Commission (due in November) remains to be seen. But what is the alternative to the Code? A regulator? Or a formal list of prohibited practices enshrined in law?.

Finally, and perhaps closest to home we have renewed speculation about consolidation among the big 4 or 5 retailers. The Commission anticipated this possibility and fired a few warning shots across the bows of a would-be consolidator. Any promised benefit to consumers in the form of lower prices will be balanced against loss of consumer choice at local level and the impact of a further concentration of retailer power on suppliers. So the regulatory hurdle is high – perhaps not impossibly so – but still formidable. Whether any will try to jump it, remains to be seen.

Q. John Kennedy, Rutland

We have seen a lot recently in the Grocer about e-auctions in various sectors of the industry. I've heard about it on the confectionery side but not on the bread side yet. Is that likely to happen and will it be detrimental to the industry?

A. No, I haven't heard of it in the bread side. From our experience we have participated in some e-auctions particularly in non food where it can be quite helpful and in certain commodity areas. We bought some UHT milk at an internet auction. Unfortunately nobody told me about it , in so far as it was sourced in France and when I had made a pledge to the dairy farmers that we were 100% British – oh dear! – we had to tale it off sale very quickly. I'd be surprised if e-auctions developed significantly in bread . Internet auctions are becoming more widespread but I don't think it is significant yet

Q. John White, London

Thank you for what you said. As the person who commissioned the Dobson report I feel I should comment. It is an important issue for us and I think we have to be carreful not to extrapolate from an over simplified view of the argument and then atttack that. I don't think anyone is blaming the retailers, even though you come under attack from certain quarters. I have been very careful to explain the FOB's view is that this is a consequence, as you said, of competition between retailers and producers. We got to a 7p loaf four years ago but we only got back up to 15p thereafter where it remained for the next 4 years until recently we got to 19p but still below cost. I think it is important that we emphasize what the Competition Commission said in relation to public interest – it acts against pubic interest – and they have looked at very hard from that viewpoint. Where we have disagreement is in what needs to be done and I think that they were quite cursory in their consideration of possible remedies. I don't think that just looking at France and Ireland's propositions in dealing with 'below cost' was wide enough. There is a very good law in Germany which deals with 'below cost' selling where as you know price competition is very intense and there are large retailers. It was certainly worthy of examination. Dobson also identified a number of other remedies and I'd be grateful for your views on those. For example, an information remedy where prices were published very widely – possibly through the internet – possibly some possibility for removal of prescribed weights. Banning it is only one option. I think we are probably both on the same side, we'd like to see an end to the practice. How we get there is the question and I think there is a useful dialogue to discover what is the most appropriate route.

A. As far as we are concerned we'd be happy for that value line to disappear altogether and we are selling at cost at the moment and the figures tell their own story – it is declining as a category. It may have had more serious effects on pricing in the past than it has now. Generally speaking, taking the top 5 or 6 retailers, the value lines are less than 10% of our sales. There is one exception to this which is Tesco. For some reason it is approx. 20% of Tesco's plant bread sales. It took a long time to get back up because of the rivalry between Asda and Tesco. Asda were reluctant to move to get Tesco off the hook. Unfortunately the industry became a casualty of that. If you got rid of the value line, I think you would find the focus of attention, particularly between the EDLP players in the market, was very much on the supermarkets own brand lines. It would just transfer itself and you would find enormous downward pressure on the prices of those products which might be detrimental to the manufacturers' brands. At the end of the day I'm not sure the industry would find the outcome palatable. I think the value lines are withering on the vine.

Q. George Weston, Buckinghamshire

Can I pick you up on a comment you made. You said there would be no reason to have it – that is, value bread – unless you could sell it below cost. You have it so that you can sell it below cost, why?

A. I am looking at it from the viewpoint of those retailers who do still sell below cost. A value line has to have a particular purpose. It's there to appeal to those who want particularly low cost bread. If you are not allowed to sell below cost the rationale for having a value line per se becomes questionable. So you probably phase it out as it seems to be declining anyway and that means that the focus of competition moves to the next one above.

Q. Tony Cavan, London

Previously I negotiated on behalf of the NAMB at this Competition Commission investigation into supermarket trading practices. To my knowledge none of our members who supplied supermarkets gave evidence because they were too terrified. I have anecdotal evidence from people in my own area – one baker supplied Tesco. Last year he was asked to send 3000 croissants to a Labour Party conference in Brighton. When he presented the bill he was told that 'that was your contribution' - that business no longer exists. I read in the Telegraph of a farmer who had 1 or 2000 tonnes of organic potatoes to be required next day at a major supermarket and the order was cancelled overnight. I know of another baker waiting 21 weeks for his money, finally got that period down to 16 weeks and now no longer trades with them. My business survives because we have never traded with a supermarket. There are lots of practices out there that don't give any credit to the supermarket movement and I do hope that one day things will improve. The relationship with farmers, not all their products goes through suppliers – we have, potato men, fruit men, vegetable men, supplying supermarkets direct. 'Oh, we'll do you a promotion, you will lower your prices for 3 weeks' or 'it was so successful, you will lower your price for another 3 weeks' and so on. All these habits are rumouring around the trade and we want to see a better face for the food industry as a whole.

You say that small suppliers were afraid to complain to the Competition Commission. All those complaints were entirely anonymous and people could have made a coherent point if they wanted to. In fact of all the 1000's of small suppliers who could have complained, the commission received in total 200 complaints. Some of them were very basic, very anecdotal and there was very little evidence behind them. We have a code of practice, we have a provision wherein the code that people, if they feel they are being badly treated, do not even have to complain in their own right. They can complain through a trade association or the NFU or whoever. And if this code is seen not to be working then there will be remedies for that as the Government will not sit by and watch it being openly flouted. They have invested far too much credibility in this. I'm not here to defend everything that every supermarket has ever done. What I will say is that what ever has happened in the past, there is a code in place now, and some of us are taking it seriously. If it is not seen to be working in the not too distant future, then we can look at alternatives.