"The Bakery Market Revisited"

Dr Kevin Hawkins

You are right to point out my frequent appearances on TV and radio because its yet another example of how bad news sell well and this morning I was on Bloomberg TV talking about the last set of retail sale monitor figures for September showing yet again a decline in like for like sales. That is seven months out of nine when we've been reporting declines and it's across the board, its every sector of retailing. It really is a hard life being a retailer Joe, and never more so than at the moment and you people who make bread are really very lucky. And I must say Virgin train's rolls could do with a bit of product development.

A couple of thoughts for the day, a couple of quotations, one from a retailer and the other from a big manufacturer, both of which I think strike a note of optimism about the bakery market which certainly was hard to find three years ago when I last spoke to this conference. What I said then three years ago focused on the trend towards convenience eating, the growth of premium and speciality breads, corresponding decline in standard products and I also talked about Safeways strategy in the bread market which as you know is now a mere object of historical curiosity, and I covered a few non-controversial issues such as below cost selling and the power of the big supermarkets. Well these issues, unlike Safeway, are still very relevant. In fact Safeways demise has actually made the concentration of market power in retailing an even bigger topic than it was then.

Let's just have a few top line indicators about what's been going on in the market place. Well first of all volume sales are down 5% over the last five years, volume sales of bread, but in value terms they are up by 9% which perhaps suggests that consumers are trading up to higher priced products and also there has been quite a bit of price inflation across the range contrary to those people who were saying three years ago the industry was stuck in a low price trap. Plant bakers have strengthened their grip on the market, they now have 80% of volume sales and 77% of value sales and conversely the share of Instore bakery has gone down from 19% to 17% in both volume and value while the craft bakers are down to 6% by value, 3% by volume. Premium white is the big growth story. 43% of the white market by volume, 46% by value and still growing. The other factor that's perhaps more significant now than three years ago, speciality bread, including a lot of foreign products now counts for 28% of the market and its growing strongly. There has also been some useful growth in morning goods up 7% in value and still growing and what I am sure you regard as really good news is that the supermarkets and other grocery multiples, including ISB now account for 87% of bread sales in value terms. That leaves craft bakers with 6% and the independent grocers with 7%.

So what's driving these trends? Well let's remind ourselves, if we needed reminding, that bread is actually a mature commodity market. It's bought and eaten by 99% of households but volume sales are down by just over a quarter since the mid 1970's. Nothing peculiar though about bread because all the traditional commodities have been declining, as you can see from this slide, and some quite remarkable falls. Liquid milk is down by 38% since 1974, carcass meat is down by 43% since 1974, sugar and preserves down by 75%, fresh potatoes down 54% and traditional drinks down 48%. So actually in those terms bread hasn't done too badly.

The other side of the coin of course is that convenience and added value foods have gone up. If we look at takeaway foods, they've doubled. Processed potatoes, things like crisps and chips and so on more than doubled. Meat products, the added value products, up by one third and so on. So you can see the way things are generally moving.

The falling bread category consumption since 1998 has really been driven primarily by the decline in white bread. Most other products within the category have held reasonably well, as you can see from this chart and some of those products the consumers see as alternatives to bread on certain meal occasions, such as cereals and so on, have actually held up and in fact increased their percentage.

If we look at consumer trends in a bit more detail and I have taken 'less is more' as being a sort of keynote to describe these trends, the main driver of falling consumption is not that there's been a significant growth in non users of bread, it's the fact that the heavy users, those who eat bread more than once a day, have actually been reducing their consumption. And these figures suggest, if you look at the heavy users under white, you can see there's been a 5% drop just in the last two or three years but there's been a slight shift of the heavy users into the medium category, they're up 2% and perhaps a smaller shift of the medium eaters to the light category, up 1.6%. So that's really the story, its not that people are deserting you, its just they're eating a bit less of it and we get the same picture when we look at changes in the type of bread eaten. Again its white that's experienced the biggest reductions, both in total and as the bread that's eaten most often, whereas wholemeal and granary and other types have increased their frequency of usage. The main long term weakness in the white bread market is that the demographic and the social trends that once favoured it are now moving away. If we look at the heaviest white bread users they are young, social class D E families, around two thirds of them are reckoned to be heavy users compared with less than half of social group A B's and conversely the heaviest brown bread users are the A B group, around one in three of them are heavy users compared with only one in five D E's. The 15 – 24 age group are the heaviest white bread consumers, over 90% of that age group eat white bread compared with only 72% of the over 65's. Now the problem is of course that demography is working against them. Over the next five years the increase in the 15-19 group is going to fall to nearly zero whereas the older groups are all projected to go up quite strongly.

In social terms A B's are the least heavy users of white bread but they are projected to go on growing from one in five of the population in 1998 to over one in four by 2009. But if you look at the D E's and the C2's they are going to decline from 51% of the total in 1998 to 44% in 2009. So if society is getting richer, more affluence, and as demography changes the number of young people in those key target groups is declining then quite clearly the market is working against standard and seems to be pointing very heavily toward continued growth of premium and speciality products.

Another aspect of consumer behaviour is the growing interest in healthy eating. Now I've read somewhere that some research by the Federation of Bakers suggested that around 16% of consumers are reducing their bread intake because they believe it to be unhealthy or in other words incompatible with a low carbohydrate diet. Now frankly, I'm a bit skeptical of those results. I don't think that the low carbohydrate diet is a powerful influence on more than a small minority of consumers and that isn't just my opinion, some research from the IGD a year or so ago suggests that when you ask consumers what they are doing to eat more healthily there's a very strong focus on eating five portions of fruit and veg a day and on functional foods, and on local food and food that’s free from artificial colours and flavours. Coming right at the bottom is the foods for low carbohydrate diets such as the Atkins Diet which as you know if falling out of favour anyway. So I don’t think Atkins, or any other low carbohydrate bandwagon is really very important here, but, there’s no doubt that a minority of consumers are buying bread which claims to be lower salt, lower fat, higher fibre and so on. And obviously that’s stimulated both manufacturers and retailers into new product innovation to extend the range of “healthy breads”. I think the challenge for the industry is to make these products tasty and appealing. We, as an organization, and it was the same when I was at Safeway, we keep saying to the Food Standard Agency, look you can take out salt, you can take out fat, you can take out sugar, you can reduce them to a level where the product is absolutely tasteless, and long before you get to that point consumers will be voting with their feet and they’ll be buying a lot less of it. So it’s a question of balance and it’s a question of moving gradually once you are messing around with an established consumer taste.

I think a more influential long term trend is encapsulated in the word “convenience”. This is as you know driving the growth of snacking in general and of the sandwich in particular and in those five years or so 1998 to 2003 the sandwich market grew by 37% in real terms or 45% at current prices and there’s no reason why this growth should slacken in the medium term.   And why has it grown?   Well for a start you have a much wider availability in the High Street, you’ve got far more sandwich shops, you’ve got Boots, W H Smith and other non food retailers now selling sandwiches as well as petrol forecourts etc so I think the old tradition of making sandwiches at home so that people could eat them in the workplace really has declined considerably and probably helped to reduce the overall demand for bread.

And another illustration in the way habits are changing is of course the decline of the cooked breakfast and the widening of the breakfast menu now to include products other than bread. Again if we look at some IGD research you can see how cereals and toast is dominant especially at weekends and then you look at the full range of options there and the strength of the cereal range comes over loud and clear. And I’m told that cereal bars for example have doubled their sales since 1999 and now represent a £200M market. Its interesting that while, I know they’re a small minority, but about 16% of consumers who say they skip breakfast, 80% still eat breakfast regularly. It’s very clear that its speed, convenience and cost that are the main factors influencing consumers when they choose what foods to eat at breakfast. So as you can see, IGD research again, it's a quick meal, its easy to prepare, its inexpensive, satisfies my hunger in a morning, gives me physical energy, these are all functional requirements so bread really has got to tap into that kind of consumer psyche. There's no doubt there is more scope for innovation, product innovation to challenge cereals for breakfast and to some degree, which I'll come to in a moment, the morning goods market I think is supplying quite a bit of that innovation.

But then, outstanding feature of the bread market is the displacement of standard white by premium white. Consumers are paying more for their bread but they are eating less of it and over the past four years sales of standard white sliced have fallen by 31% while premium white sales have increased by 40%. So that gives premium an almost equal share of the market with standard sliced, and as you can see standard unsliced is also losing ground. Now the growth of premium brands is not peculiar to the bread market. Premium brands are gaining ground across a whole range of fresh food. Why? what's the big attraction? Well again IGD research says quite plainly that as far as consumers are concerned what attracts them is the high quality of the ingredients that they associate with premium brands. The strength of the brand itself whether it's a retailer or a manufacture brand is also very important and then you get a whole range of minor things coming in, but it is the quality of the ingredients used, and also for certain types of product, the supply chain, where its come from, whether its local or not, what's going on in the supply chain, its that kind of consumer interest which is really driving it. Just to remind you, those of you who were here three years ago, I showed you Safeways premium range of breads and indeed other products which we called "The Best" and amazingly Morrisons have kept it. Sainsburys have "Fresh Handcrafted Bread", again a premium line and I think it's a fair bet that there's scope for a good deal more growth in the premium bread market. Just to illustrate what's happening in certain other categories, the two strongest premium categories at the moment are fresh meat and fish, fruit and vegetables. Now how does bread stack up against them, well actually, not bad, but significantly lower. And then you get to the more commodity end where really premium is not very influential at all. But I think there is plenty of scope in there for bread for that 31% buying premium all the time, to expand.

The other winners of course in the bread market are speciality breads and they are doing quite nicely, thank you. If we look at what's happening generally, sales of these speciality lines grew by 50% between 2000 and

2004 and although garlic is still the biggest single line you can see that Indian, Tortillas, and Italian are actually the fastest growing lines. Starch reduced seems to be the only speciality bread that seems to have peaked. These foreign specialities are now around 25% of the plant bread market, up from 18% back in 2000 and they certainly look set for more growth, and foreign products are also driving the growth in morning goods. Sales of these products have gone up by nearly one third just over the past five years, as you can see particularly strong growth since 2002. Some of which of course has been at the expense of traditional rolls, which are down nearly 10% since 2002. If we look in a little more detail at these bakery snacks and foreign recipes, you can see that bagels are the fastest growing, 50% up since 2000, hot cross buns 34% up, croissants up 33%, Danish pastries up 30% and American sweet muffins up 29%. Average growth across all these products nearly 19%. Plant bakers of course dominate the morning goods market, they've got 63% of the market, but ISB has a 30% share and its actually increasing its share of morning goods. Craft bakers unfortunately are losing share which is perhaps surprising because these products sell themselves on freshly baked freshness, the smell, the appearance and so on. You would have thought that craft bakers would have done a bit better than they appear to be doing, but maybe that's going to change.

So if that's the market place lets turn now to the perhaps slightly more contentious issue of retailer/supplier relations. When I addressed this conference three years ago I focused on below cost selling. Now critics at the time claimed that persistent selling below cost was "blighting the category" that retailers were "stuck in a competitive low price trap" and that suppliers/manufacturers were powerless to influence them. So is below cost selling still a problem?

Well it obviously still exists in the shape of economy ranges on supermarket shelves and even Waitrose sell a 25p white sliced loaf. But I said three years ago that these value lines were rapidly losing market share and the process has continued since then. In fact retailers own brand ranges, both standard and value lines have been losing ground. Back in the mid 90's they had a 60% market share, now they're down to 36% last year. Far from being powerless to move the category forward I think the big branded manufacturers have shown quite the contrary, that if you invest in advertising, new product development, you can drive more value into the market. So much so the retailers of course are now mounting a challenge to rebuild their own brand share, not by cutting prices, by investing in their premium brands and launching new speciality ranges. And even if below cost selling was a big problem, what could you do about it. You may recall that five years ago the Competition Commission when it surveyed the supermarkets said that "persistent below cost selling was against the public interest but it didn't see any particular practical remedy that would work". They recognized that it would be difficult to identify those products that were being persistently sold below cost, that short term promotions would have to be allowed and that the big retailers could actually circumvent any ban by obliging own brand suppliers to reduce their cost of supply to such a degree that would allow the retailers to go on selling at a very low level but still at a profit. Certainly the evidence from France and Ireland where below cost selling is banned suggested to the Commission that it wasn't going to work in the UK, the only result would be higher prices to consumers, higher margins to retailers and less competition.

And that neatly brings us to the issue of where power lies in the supply chain. You may say it's very obvious where power lies, it's with the big retailers, look at the current level of concentration in the retail market. With Morrisons acquisition of Safeway the big four retailers now have 75% of the total grocery market. Believe it or not this is not exceptional, either by the standards of other EU member states or even in some of those EU members recently joined and which are rapidly concentrating. And the overall market shares of the big four are actually replicated in their respective shares of the bread market.

Now concentration is a characteristic of all mature markets and in the bakery industry of course the same process has been at work on the manufacturing side. The top three brands have 50% of the market. The drive for scale economies is common across all sections of the food industry and from one end of the supply chain to the other, even affects farming. But if the retailers have got too much market power you might expect them to get some very significant benefit in terms of either margin growth or margin levels or some combination of both. In fact the reverse has happened. As you can see from this chart this is net operating profit margins. Over the past ten years the general trend has actually been downwards and in two cases, namely Morrisons since it took over Safeway, and Sainsburys, the trend has been very sharply down. And even Tesco, and we are all familiar with the Tesco growth story, its doubled its sales since the mid 90's, its market share now nearly 30% but its making exactly the same margin, 6.2%, last year as it was ten years previously. So where have all Tesco's scale economies gone. Not in shareholder dividends, no, they have been reinvested in driving Tesco's market share. So cutting prices, expanding its store portfolio, developing new products and customer services and of course expanding abroad. The bigger their share of the market, the bigger anyone's share of the market, the better trading terms you get, certainly from UK based suppliers. But the other big players of course have to compete with Tesco head to head in most locations, so the squeeze on their margins has grown and they're obviously trying to improve their supply terms but without the benefit of Tesco scale, and that I think to some degree explains the pressure on suppliers now and for the last two or three years, and complaints about the big retailers so call 'bully boy' tactics.

It's fairly obvious I think why, you can see that there by the way, market share versus operating margin performance map. Tesco on a five year view have slightly increased their margin, not on a ten year view as I said, very slightly. But look where the others have gone, even Asda going down slightly there. Sainsburys way down. Morrisons post Safeway acquisition falling. Somerfield going the wrong way. Waitrose coming up, but that's because as you know Waitrose have a particular market which isn't as price sensitive, or market share sensitive as the others, and of course Iceland going very sharply in the wrong direction.

So when people talk about Tesco's £2B pre tax profit, and implying that all the big retailers are making money hand over fist, bear in mind that isn't so, and apart from Tesco to some degree they are all struggling at the moment.

So it's fairly obvious I think why the suppliers Code of Practice that was launched in March 2002 and is mandatory on the big four retailers has not worked as was originally intended. And if you recall the purpose of the Code was to establish a set of Queensbury rules, it was there to set standards about how you should behave, it was not there to determine the outcome of trade negotiations, and its worth just quoting a conclusion from the OFT's very recent review of the Code of Practice, when they said "the Code of Practice is not meant to shield suppliers from hard bargains driven by supermarkets and most importantly consumers are benefiting from competition in grocery retailing". Its no good suppliers simply moaning about being squeezed, the OFT will only act if there's clear evidence that supermarkets are acting in a way which restricts, distorts or prevents competition and there's a disbenefit to consumers. So, do we need a new Code? Well there is certainly an argument that says that any Code which covers only the big four retailers and those suppliers who have got direct commercial relations with the big four leaves some gaps that ought to be filled. But I think the problem is that when you think about the alternative there are three roadblocks that it immediately runs into. First of all no Code can under competition law concern itself with the content of trading agreements. Second any complaints about supermarket behaviour under any Code have to be made in the first instance to the retailer concerned by the aggrieved supplier. There is no way of making complaints anonymously and the OFT has ruled that out completely. As it said it is standard practice for an Ombudsman when he receives a complaint to send a copy of it to the body complained about. And third there is no obvious incentive for those retailers who are not currently covered by the Code to volunteer for inclusion in a wider alternative. So it seems we are stuck with this present impasse until either suppliers start making use of the Code, or the Competition Commission decide to scrap it, neither of which seems at all likely.

So to wrap this up what does the future hold for the bread market? Well Mintel is projecting a further decline in volume of 3% by 2009, led by standard white sliced bread. Premium and speciality products will drive the market forward, Mintel projects value growth of 9% in this category closely followed by wholemeal and granary and this growth as we see will be fueled by increasing number of AB consumers and further product innovation, but, while the value of the total market will grow around 5% at current prices, at constant 2004 prices Mintel are forecasting a decline of 3%. So a lot is going to depend on the willingness of consumers to continue trading up. Now consumers interest in healthy products should be a continuing source of margin growth and there should also be some scope to increase consumption in the 55 plus age groups who eat less white bread than any other group and of course demonstrate relatively high levels of interest in the healthier options.

But I think we also need some more Instore Theatre, by how we sell bread. We still sell bread too much like a commodity in too many stores. I think we need more attractive merchandising and more product tastings. A couple of examples here from France – this is how Auchant do it in one of their hypermarkets which is a bit different from how you see it in most British supermarkets, and this one is from Carreffoure hypermarket, again a little bit of theatre in there.

Finally I think retailers will have to continue investing in good promotional offers. Young, hard up DE families are particularly switched on to promotions but all age groups and social classes respond to good value offers, whether discounts, BOGOFs, what have you, or indeed extra product free as in this example from Morrisons. So what we have now is some quite vigorous competition between retailers and manufacturers to develop more added value, higher margin products which is obviously a more positive scenario then we were contemplating, even three years ago. Although I have to say all the current trends were visible then. Morning goods for example, high value products where there has been a lot of product development in recent years, and its interesting that nearly two thirds of the new launches in morning goods have been retailers own label products.

The question is can this growth be sustained? Will consumers continue to pay more money for less in terms of volume but more in terms of quality, taste, healthiness and innovation. What happens if and when the current spurt of innovative product development runs out of steam, or consumer spending gets itself into a long phase of very slow growth which some economic forecasters are anticipating. What happens if price suddenly becomes much more important as a determinative consumer choice? Well I would be fairly optimistic frankly about the future. I think the distinguishing feature of bakery is that the big manufacturers followed by the retailers are successfully decommoditising the market and differentiating the offer by adding value. The dairy industry, to quote another example of the traditional industry, is belatedly starting to move in the same direction by launching new added value brands of liquid milk to reverse the long decline in their market. Once a market is decommoditised as least in part, it’s unlikely to revert back to what it was.

So I hope we can work together to make sure we keep things moving in the right direction and let us end on a positive note.

Question: Joe Street, Banbury

You may be aware that I’ve been involved very much with a common industry trait and I guess that by now you will probably have heard that one *of the major retailers as an initiative is intending to introduce a common industry trait, that is to say all their supplying manufacturers will supply in a single piece of equipment. Do you in the BRC welcome that initiative?*

Answer: Well we try not to take positions on what an individual retailer does, especially if it's controversial. I suspect it's probably the first of a general move and I think its part of something that's been going on for quite some time now, but with very slow growth in the market generally and more slow growth forecast. Any cost you can cut in the supply chain is, I think, viewed as fair game and if that means common trays whatever, then I think the big retailers led by one or more will be looking very hard at how you can reduce costs, improve delivery times and so on. You may see it as a threat, you haven't expressed an opinion.

I certainly don't see it as a threat. It's something I proposed about twenty years ago.

In that case it's a brilliant idea! If your growth is pretty slow overall in most categories, and your prices are falling or you are really having to cut into margin to drive sales, but your fixed cost base is rising, like labour, property, rent, rates and energy, if you are a retailer you can't cut staffing beyond a certain level, otherwise customers will go somewhere else. You have to turn to the supply chain. You might say that just means screwing suppliers into the ground and yes, of course, it does mean hard bargains, to use the OFT's terminology, but I think as everyone familiar with a big complicated supply chain knows, the amount of time it frequently takes to get from manufacturer through the supply chain to the final consumer, the amount of waste there is in that supply chain, the mismatches between supply and demand, either too much in the wrong place or not enough in the right place, whatever, and the fact that modern technology, although its solved a number of problems hasn't solved everything because it takes people to operate the technology. There is still an awful lot of cost cutting potential I think in some supply chains and that inevitably is going to be a major focus in the next few years.

Question: John Kennedy, Rutland

As an ingredient supplier to the bread industry and a BRC Higher Level accredited company, we are constantly bombarded with requests from our customers to fill in specifications in their own formats dependent upon which retailer they are supplying. Is there anything the BRC can do to try and help the burden that is on ingredient manufacturers, because the level of work that is demanded of us now is totally disproportionate to the level of business we are actually gaining?

Answer: The problem is of course that composition, not just of bread, but of all products, is now regarded as very competitive business. This is one of the difficulties of trying to get agreement among retailers on things like healthy eating initiatives from the Foods Standards Agency, you know, reducing fat, sugar, salt, because fat, sugar, salt as I said a moment ago do drive taste and taste drives sales. But if you start fiddling around with these things too much you start losing sales. I think it is something we would look at, because as you know we do get involved with product standard, and quality standards and so on. It does become difficult once ingredients and ingredients mix and so on, and own brand in particular, becomes very sensitive and very competitive but if you'd like to email me with a proposition with what you think might be a solution, or the beginning of a solution. I will give you my card afterwards, and we will have a think about it.

Question: Paul Heygate, Bugbrooke

What is the BRC doing with regards to the previous question on education rather than allowing legislation to come forward, particularly with reference to things like salt, and surely is it right we should have someone like Jamie Oliver telling us how to feed our next generation of children correctly when we, the food retailers, should be doing it. It's the Governments objective to deal with obesity, what are you at BRC doing?

Answer: From what I said a moment ago, trying to get agreement among retailers to proceed together on an issue which many regard as very competitive, because it's all about taste, I think is one of our biggest challenges. Now three years ago we all signed up to the FSA's protocols on salt reduction and we've been actually delivering, gradually, because as I've said if you change composition of foods, you change their taste jerkily so that it becomes quite obvious to consumers that their favourite food doesn't taste like it used to, then they are going to react badly. And with salt in particular, with ready meals and so on, the tendency is that if this salt is missing from the product they'll just add it back when eating it which defeats the object of the exercise. It is really the job of retailers in themselves who are nearest their customers to actually influence the way customers behave. Trade Associations have limited influence in these areas, but what we can do, and what we have done is to encourage all our members to actually regard healthy eating as an opportunity and not a threat. The critics of the food industry, there are some in the Food Standards Agency shall we say, who are not our best friends, think that we have a vested interest in piling as much fatty, salty, sugary products into our customers and I've frequently said on occasions, we are actually quite the reverse, we actually want our customers to eat healthily and live a long time and go on shopping with us and not eat themselves into an early grave. So we do work closely with FSA, with the Department of Health. I happen to sit on something called the Food & Health Action Plan Implementation Group, you may recall earlier on this year the Government produced its Food & Health Action Plan which is a broadly based strategy covering, not just food, but exercise, drink and a whole range of other things. Its one thing to produce a strategy, produce a leaflet in store, or a lovely piece of point of sale exhorting customers to choose the healthy option, or some rather nice packaging, or product innovation. But at the end of the day what you can do is make the choice available and make it attractive, you can't compel people to eat healthily if they are not minded to do that. If children in particular, are brought up in households where fat and sugar and salt are part and parcel of everyday dieting, and there's no fresh vegetables, there's no fruit, its all convenience food and its all high calorie stuff, its very difficult for anybody else to break into that cycle and to get people, and children in particular, to eat more healthily which is of course where the schools come in, and I wish Ruth Kelly and her committee that have recently decided to ban all vending machines from schools, all the very best but I suspect what it might do in many cases is set up a rather interesting black market in exactly the products they are taking out of vending machines or banning. And if the kids aren't getting healthy eating at home or getting encouragement from parents, I doubt if that in itself is going to change the world. Sorry for a long rambling answer to a very interesting question, but we do our best because we do see the future of the food retail sector in moving with consumers, encouraging them to eat more healthily, as part of a healthy lifestyle because just exhorting people to eat healthily isn't in itself going to solve the obesity problem. There's got to be physical exercise and a number of other things done as well. It's actually educating people to think about healthier lifestyles, not just food. I agree it's annoying sometimes to be on the defensive when the, what I call the food puritans, get on their bandwagon and start talking about legislation and banning this, that and the other. I don't believe that's the way forward but education of any sort takes a long long time to have an effect.