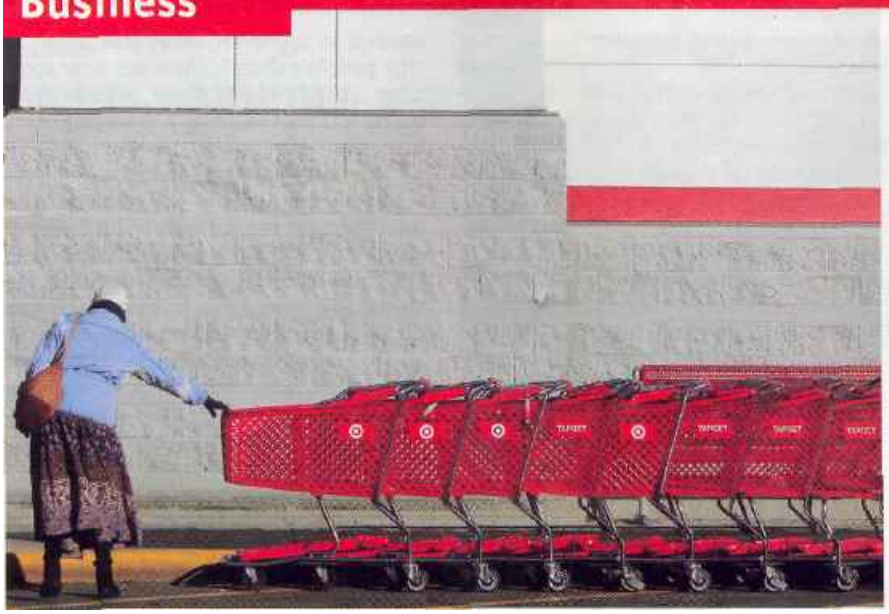


Also in this section

Business.view, our online column on business, appears on Economist.com on Tuesdays. Past and present columns can be viewed at www.economist.com/businessview

The food industry

Tightening belts

As commodity prices rocket and America's economy sickens, food companies and retailers are racing to adapt

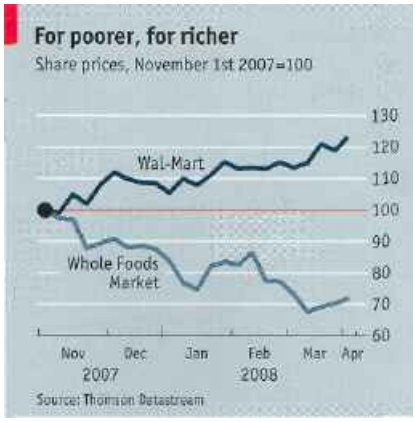
THE food industry is being squeezed from all sides. Last year prices for milk, eggs, corn, wheat, oils and almost all other edible commodities climbed to unprecedented levels. They are still rising, although at a slower pace. The prices of electricity and fuel are also on the increase, which makes processing and distribution more expensive. And passing on higher costs is not easy when customers too are feeling the pinch, as unemployment rises, the value of their homes falls, and inflation erodes their purchasing power.

In one sense, food is recession-proof, since people have to eat in good times and bad. What is more, over the past 30 years the share of food in American and European household spending has fallen from an average of 30% to less than 10%, so consumers do not care about price hikes as much as they did in the past. Even so, they are responding to the economic gloom by changing what they eat, where they eat and where they buy their groceries.

Martin Deboo, an analyst at Investec Securities, a stockbroker, uses the well-worn but apt analogy of the "perfect storm" to describe the industry's predicament. Those best positioned to weather it include multinational companies with diversified customer bases, such as Nestle, Unilever and Danone, as well as retailers that focus on low prices, such as America's Wal-Mart. Among the losers are posh grocers such as Whole Foods Market, a firm based in Texas which specialises in fancy, often organic food (see chart). The downturn also hurts smaller companies that do not have the benefits of scale, depend too much on customers in a single country or region, and do not add much value to the commodities they process.

Nestle, the world's biggest food firm, has so far coped well with the rise in commodity prices. Its sales around the world grew 7% last year compared with an average of 1.8% for the industry. Like most of its rivals, the firm has passed some of the price increases on to its clients. But it was better prepared for inflation than most. "We saw this coming, so we hedged by forward-buying raw materials," says Franc.ois-Xavier Perroud, Nestle's spokesman.

Far-sighted and nimble sourcing, needless to say, has become more important than ever. Nestle, which uses lots of milk making baby formula and chocolate bars, buys it under contract directly from farmers, rather than on the open market, where prices jumped by as much as 50% last year. It has also changed the recipe of some of its goodies to reduce their milk content.



But even clever purchasing is not enough to help makers of lightly processed or generic products, which tend to have slender margins. So Nestle is getting out of the business of making basic wholesale products such as tomato puree and cocoa paste. It is also putting a huge pasta factory at Sansepolcro in Italy up for sale, though it will continue to use much of its output, and to sell fresh pasta dishes, sauces and other more profitable Italian products under the Buitoni brand.

Hold the soya oil

Kraft, one of America's biggest food firms, is struggling with the soaring prices of its ingredients. The cost of these jumped by 9% or $1.3 billion last year, taking a bite out of profits. The Illinois-based company says it is working hard to defray the extra expense by saving money elsewhere. But it believes its best defence against rising costs is to go on the attack, with products and marketing that are better suited to leaner times. For example, the company has changed the recipe and packaging of Miracle Whip, a salad dressing and sandwich spread that is advertised as having the taste of mayonnaise with half the fat. It now comes in a plastic jar instead of a glass one, and has a wider opening that allows buyers to scrape out the very last glob. It now contains less soya oil, which is both fattening and expensive, and more water, which is slimming and cheap.

Kraft has launched a new pizza called DiGiorno Ultimate, in an effort to lift its DiGiorno brand of frozen pizzas into what it calls the "super premium" category. The ;

idea is to offer consumers a cheaper alternative to eating in pizzerias, which rack up $35 billion in sales each year in America. Customers seem to like it: the DiGiorno Ultimate accounted for a third of all sales of new sorts of frozen pizza last year. To keep the pizzas flying from the freezers this year, Kraft plans to offer individual servings of both its DiGiorno and California Pizza Kitchen brands, aimed at single people who might not enjoy a lonely meal at a pizzeria anyway.

American restaurants are also feeling the effects of the slowing economy, according to a spokeswoman for the National Restaurant Association. The industry is still growing: sales are still forecast to reach $558 billion in 2008. But the rate of growth, at 4.4%, is lower than in previous years. So far restaurant-goers are not cutting back too much on their restaurant visits, but they are spending less each time. Restaurateurs are trying to avoid passing the higher cost of ingredients on to customers by increasing productivity-by training waiters to double as kitchen hands, for example.

Cheap restaurants are becoming more popular. McDonald's, the biggest fast-food chain, did much better last year than the year before, though the firm says it is not sure whether to attribute this to higher food prices, revised menus or aredesign of many of its outlets. Its customers do not (yet) seem to be trading down to "value-priced" food, but then all the items on its menu cost less than $10.

Just to be on the safe side, McDonald's has come up with a whole menu of items that cost just $1. It has started an advertising campaign aimed at "Dollar Menunaires". Its rivals have followed suit: Wendy's and Burger King are both selling double cheeseburgers for $1. Even Starbucks has plans for a $1 coffee.

Another firm that is thriving in the stormy environment is Wal-Mart, the world's biggest supermarket chain. It argues that its obsessive focus on low prices is in keeping with the straitened times. The firm is working with food producers to come up with ever-cheaper offers. "We aim to be, wherever possible, the first to lower prices and the last to raise them," says a spokeswoman.

Food prices are likely to remain high for some time. The trends that are feeding the inflation, including increased demand from developing countries and the growing diversion of crops to make biofuels, show little sign of slowing. But necessity is the mother of invention; and the food industry seems to have no shortage of fresh recipes. ■

Fonte: The Economist, n. 8575, p. 71-72, 12 Apr. 2008.