

# Food Industry Update

Challenges, Opportunities, Impacts

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## **BUSINESS CHALLENGES -**

**Highly Competitive Industry** - Due to the proliferation of product choices in many food segments, competition in the manufacturing industry is intense. Companies compete with other products within their specific industry and similar alternatives. For example, seafood processors compete with cheaper proteins like chicken; cereal makers compete with breakfast alternatives that can be easily consumed on-the-go. Food companies vie for shelf space, competing on value and brand reputation. Pressure from competitors and consumers can force manufacturers to lower prices or increase marketing expenditures. Branded items compete with private-label products that are generally sold at lower prices.

**Food Contamination and Recalls** - Each year, more than 48 million Americans get sick and about 3,000 die from consuming contaminated foods and beverages. Although manufacturers have regulations and processes in place to prevent contamination, undiscovered animal diseases in slaughter and meat processing plants or toxic mold in grain mills can cause widespread contamination and product recalls. Even a threat of contamination or loss in consumer confidence in food safety or quality can be detrimental to a processor. The USDA regulates various aspects of food processing operations and can shut plants down.

**International Trade Restrictions** - Tariffs, embargoes, and other restrictions on international trade create financial risks for food manufacturers that export products to other countries. Governments sometimes ban or drastically raise the prices of certain imports for political, economic, or health-related reasons. Outbreaks of avian flu, mad cow disease, and other livestock illnesses can prompt countries around the world to ban imports of food products from affected areas. Such policies can disrupt key revenue streams and pressure producers to make up the difference in other markets.

**Difficult Working Conditions** - Workers in food manufacturing plants — especially slaughterhouses and meat processing facilities — receive relatively low wages and often work in difficult conditions. Labor turnover can be high. Meat processing, which requires workers to make repetitive motions with sharp tools, is one of the most injury-prone jobs in the US. The injury rate among rendering plant workers is more than 200% higher than the national average for all US industries.

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**Labeling Genetically Modified Products** - Laws requiring food manufacturers to label products containing genetically modified (GM) ingredients could lead to higher packaging and compliance costs for the US industry. In response to growing public demand for transparency in the food industry, the USDA is developing a framework to standardize GM labeling nationwide. Many food manufacturers were initially opposed to stricter GM labeling regulations, but the industry is now largely in favor of a uniform standard to avoid the high costs of creating distinct packaging to comply with inconsistent laws in different states. Companies including General Mills, Kellogg, and ConAgra Foods have added GM labels to most of their national brands in anticipation of further regulation.

**Center-Store Aisles Shrinking** - Supermarkets are scaling back on center-store shelf space and merchandising displays as more consumers seek out fresh foods and shop for groceries online. The trend is requiring major packaged food manufacturers like Kellogg, General Mills, Kraft Heinz, and ConAgra to compete more intensely to get their products in front of shoppers. Food companies are working more closely with retailers to develop shelving and display strategies that make their brands more visible and appealing. Grouping healthy snacks such as nuts and granola bars in dedicated sections, for example, has been shown to increase sales

## INDUSTRY OPPORTUNITIES—

**Healthier Offerings** - Many manufacturers are reformulating products to include healthier ingredients or ingredients that are perceived to be healthier by consumers. New offerings are often made with organic wheat flour, cane sugar, rice syrup, and corn starch, for example. Dairy products are one of the fastest-growing segments of the organic food industry. Low-sodium and whole wheat product options have gained in popularity. Manufacturers often advertise heart or cholesterol benefits of their products to attract consumers.

**New Packaging** - New food packaging often focuses on convenience and eco-friendly designs. Many meat processors now cut, package, price, and label fresh meat products for immediate display on supermarket shelves. Manufacturers also sell pre-measured meal kits with the necessary ingredients and seasonings. Resealable and single-serving packages have also become more common. Many smaller packages, such as 100-calorie sizes, are designed to help dieting consumers with portion control.

**International Expansion** - Many large US food processors are expanding into international markets. Emerging markets in Latin America and Asia have consumers with rising incomes and growing interest in Western foods. A number of companies have forged joint ventures with European and Asian food manufacturers designed to take advantage of strong local consumer brands. US manufacturers often tweak ingredients, flavors, and brand messaging to the culture of a target market.

**Online Grocery Shopping** - Faced with slowing sales in grocery stores and discount clubs, food manufacturers are looking to grow revenue online. E-commerce has become one of the fastest-growing avenues for purchases of ready-to-eat food items as companies continue to increase their investments in the channel. About 20% of all US grocery sales could be made online by 2025, according to FMI and Nielsen. Items sold in center-store aisles, such as breakfast cereal, condiments, and other packaged foods, are making the shift online more quickly than others, and about 40% of center-store volume is expected to migrate online within the next decade. Digital marketing costs and shipping logistics are key considerations for food manufacturers looking to grow their online sales.

## Food Manufacturing

**Opportunity: Snack Makers Looking to Grow Online Sales** - Faced with slowing sales in grocery stores and discount clubs, snack food manufacturers are looking to grow revenue online. E-commerce has become one of the fastest-growing avenues for purchases of ready-to-eat snacks as major food companies continue to increase their investments in the channel, according to NPD Group. Mondelez International recently launched a holiday-themed website to sell tins of Oreos directly to consumers, marking the first time the company is overseeing its own supply chain and shipping logistics, Bloomberg News reports. The snack food giant established a dedicated e-commerce team in 2016 and hopes to reach \$1 billion in online revenue by 2020. The company will occasionally offer special limited-time promotions through its own website, but most of its products will ultimately be sold through third-party online retailers like Amazon. Some manufacturers have leveraged social media buzz to sell rare and premium varieties of snack foods that are unavailable in most brick-and-mortar outlets. Typical online snack food purchasers are households with incomes of \$75,000 and above.

**Industry Impact** - Food manufacturers will need to consider the cost of digital marketing costs and shipping logistics as they pursue online sales. Direct-to-consumer promotions can be effective for selling high-margin products for a limited time, but selling core product lines through third-party online retailers is generally easier and less expensive.

## Food Manufacturing

**Challenge: New Law Requires GMO Labeling** - A new law requiring the USDA to develop a nationwide standard for labeling foods containing genetically modified organisms (GMOs) is expected to result in higher costs for food manufacturers. The law, approved in summer 2016, will require companies to disclose GMOs through text labels, symbols, or digital codes (such as QR codes). The USDA has been given two years to finalize the rules. The USDA is also tasked with determining the amounts of GMO substances present in foods necessary to prompt labeling, according to *Food Safety News*. The law's supporters, which include many large food companies, trade groups, and retailers, contend that federal rules will counter a patchwork of state-level GMO labeling legislation. The legislation's critics argue that the law could make it difficult for consumers to determine if GMOs are present in foods. Despite substantial scientific evidence that GMOs are safe, their presence in the food supply remains controversial.

**Industry Impact** - Food producers may have to spend more for in-house testing to determine whether their products contain GMOs as a result of a new federal labeling law. Companies also may need additional insurance to protect against potential consumer lawsuits alleging noncompliance.

# Food Manufacturing

**Challenge: Listeria Outbreaks Prompt Closer Scrutiny of Frozen Foods** - A major recall of frozen foods contaminated by listeria bacteria is putting pressure on government regulators to take a closer look at safety practices in the food manufacturing sector. Millions of packages of fruits and vegetables made by Washington-based CRF Frozen Foods were pulled from store shelves in April and May 2016, making the incident one of the largest food recalls in recent history, according to the Associated Press. The company's recall includes more than 350 product lines under 40 different brand names, and CRF's retail customers — which include Costco, Target, Trader Joe's, and Safeway — have imposed secondary recalls of at least 150 additional products, *Food Safety News* reports. There is evidence that past enforcement of health and safety regulations has been lax at the CRF plant where the listeria outbreak originated: FDA and state agriculture inspectors documented several code violations at the facility since 2014 that were never adequately resolved. The US Justice Department is investigating a similar incident in which Dole Food recalled listeria-contaminated packaged salad products earlier this year, more than a year after federal investigators first found evidence of contamination at one of the company's production plants.

**Industry Impact** - Food manufacturers should review their health and safety procedures and ensure that all requirements are met to avoid the negative publicity, lost business, and regulatory scrutiny that results from high-profile recalls. Companies may need to devote more time and resources to comply with reporting requirements if the FDA introduces stricter measures to curb further listeria outbreaks in the future.

## Food Manufacturing

**Trend: Spices Replacing Artificial Dyes in Packaged Foods** - As consumers become more interested in products free from artificial dyes and flavors, a growing number of food manufacturers are using natural spices to color their packaged foods. Kraft Heinz recently began using turmeric as a replacement for yellow #5 and yellow #6 in its flagship macaroni and cheese brand. Annatto is another spice that is increasingly being used in place of yellow dyes, while paprika gives an orange color to products ranging from sausages to cake icing, according to *The Wall Street Journal*. Several other major food companies, including Hershey's and General Mills, are also increasing their use of spices and other natural ingredients. Food manufacturers must invest heavily in research and development to ensure that the new recipes don't affect an item's taste or texture.

**Industry Impact** - Food companies that are looking to incorporate more natural ingredients into their products may need to seek out new suppliers, increase spending on market research, and budget for higher ingredient prices.