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Understanding Structural Change in the Food Industry

...Upfront

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Understanding Structural Change in U.S. Agribusiness

As agricultural commodity prices have fallen from record levels, much attention has been focused on the depressing effect that changes in the structure of agribusiness may have on farmers' returns. Across the food and agricultural sector, the smart pace of mergers and acquisitions, along with the construction of bigger plants, has resulted in fewer and larger firms buying farm commodities, manufacturing food products, and selling them to consumers—a phenomenon known as concentration.

With fewer firms, will markets remain competitive? Or will firms be able to exploit market power to exclude rivals, to hold down prices paid to farmers, to raise prices to consumers? To begin answering these questions, this issue of *FoodReview* takes a close look at five important food industries, illustrating how they have restructured and explaining the reasons behind the changes.

Appreciating the role of the consumer in shaping the agricultural and food system is key to understanding its structure and evolution. In the United States, the quantity of food consumed in the aggregate essentially increases only with population growth. In a mature food market such as this, growth in demand for one product likely comes only at the expense of another product. Consumers may switch from one product to another based on a desire for a different quality characteristic, as from one kind of breakfast cereal to another. No more cereal is consumed, so growth in one cereal's market share comes at the expense of another's.

In the food business, the past 10 or 15 years has seen a marked increase in the number and variety of products sold. Grocery stores offer choices that provide novelty, variety, and convenience, even as they compete with restaurants and fast food outlets for the consumers' food dollar. Against this backdrop, firms look for a competitive edge by offering new products but also by lowering production costs. Cost-saving measures often take advantage of economies of scale, achieved through mergers and/or construction of larger stores and factories. For example,

• Poultry firms have built bigger plants and have differentiated their product lines, moving away from selling whole birds to offering cut-up parts and specialty items.

• Farmer-owned dairy cooperatives and propriety companies have gotten bigger through mergers and have gained cost advantages by specializing in narrower product lines.

• Supermarket fruit and vegetable offerings have expanded dramatically, as Americans are eating more produce and seeking greater convenience. Bagged salads and cut carrots have emerged on the scene, and grocers have changed the way they do business with produce suppliers to assure supply and reduce costs.

• The market for breakfast cereals has long been dominated by a few firms, which avoid price competition and instead have attracted consumers with coupons and advertising. But sales of branded cereals have slipped in recent years because of competition from cheaper store brands and the rising popularity of more portable breakfast alternatives such as bagels and breakfast bars.

• Mergers in food retailing continue apace, as supermarket chains adopt new business strategies and information technologies to lower their costs.

These industries provide ample evidence that changing consumer preferences provoke dynamic responses from processors, retailers, and ultimately, farmers. Understanding the genesis of structural change will help anticipate the effects of such concentrated markets.

Susan E. Offutt
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