

## Supermarket Sweep on Rising Food Prices? The Conundrum Faced by Manufacturers and Consumers

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### Increased Costs within the Raw Materials Industry

The increasing attractiveness of the alternative fuels market in the wake of predicted shortages for fossil fuels has caused direct competition between several basic cereal crops such as corn and wheat used for biofuels production, and the same crops used for human and animal food. In addition, the concern over the ability to supply fossil fuels due to dwindling supply reserves, combined with the uncertain political situation in several of the major oil-producing countries, has resulted in sharp price increases in fuel and transport costs. These price increases have been passed indirectly to the consumer. Modern food products tend to travel thousands of miles on average, to provide the range and choice available to consumers in the supermarket. As a consequence of these events, both food and feed production costs have also increased sharply.

### Human Food Costs

At present, various raw materials used in the food industry are at critical supply levels. The shortage of milk availability has increased the milk prices for the milk processors, and has already resulted in the reformulation of various products by various dairy processors, such as Arla Foods in Sweden. Many of these changes have arisen within the cheese industry, where there has been a focus on reformulating products to include various alternative ingredients, such as starch-derived formulations as dairy ingredient replacements. Some companies have prioritised their product ranges, removing some products from production to ensure that their most popular products remain on offer to consumers. In recent years, the dairy farming industry has been associated with low returns and producers retiring from the industry. The current supply shortage has forced dairy processors to increase the price they pay to farmers. This has allowed farmers in the United Kingdom to receive a profitable price for milk production, allowing them to reinvest in their business enterprises.

Rising prices on the world market have the potential to seriously erode profit margins for the producers. Associated British Foods reported a 12 per cent reduction in the profitability of its sugar business in 2007, due to the impact of European sugar legislation reform. Wheat prices have also increased phenomenally in the last year. The increased wheat price has been transferred to the consumer by means of a price increase in the various

bread on offer at the supermarket.

Fruit and vegetable markets are those which are most in need of sustainable development in the United Kingdom. Farmers and food producers have been forced to exploit cheap, foreign labour to maintain production costs at a low enough level to satisfy supermarket demand. This is due largely to price wars between rival supermarkets.

### Animal Feed Costs

In the animal feed industry, the cost of feed has long represented the bulk of the overall cost of animal production, and may represent about 75 to 80% of the cost in the intensive animal sectors of pig and poultry production. However, in the last few years, prices of feed ingredient materials have risen to extreme levels. The German market is the largest in Europe for animal production. In 2007, compounded poultry feed in Germany was reported to be 33% more costly during mid-September for broiler producers compared to the same time in 2006, while turkey feed prices within the Weser-Ems region were 48% higher than in 2006. These prices represent the highest ever recorded for avian compound feed in the region.

Price increases for raw materials used in the animal feed industry have been even more severe. In mid-September 2007, the price of corn increased by an average of 62% to €23.90/100kg. Feed wheat prices increased to €24.30/100kg, which made this particular cereal twice as expensive as it was in 2006. Likewise, at the Hamburg exchange, the price of soy cake with 44% protein, a common ingredient in the feed industry, was 50% higher in 2007 than in 2006 at €29.95/100kg. Situations such as these will put many producers out of business and eventually increase food costs for the end-user.

### Impact on Food Manufacturers

The increased raw material prices have forced various companies in the market to search for ways to reformulate their ingredient listings in certain products, to offset the potential for a major loss in profit margins. Added-value ingredients are the main way of boosting revenue and turnover. BENE-O-Rafti is carrying out research trials to add value to their inulin and fructo-oligosaccharide products for pet food in the prebiotics market for companion animals. Danisco A/S is assessing the potential of a new range of emulsifiers in its forthcoming pipeline to reduce the dependency on cereals and vegetable oils in human food

formulations. CP Kelco intends to use its GENU pectins in yoghurts as a replacement for dairy ingredients, normally provided from skimmed milk powder or whey to provide functions such as creaminess and viscosity. Palsgaard has also introduced a new emulsifier and stabiliser system known as IceTriple, which can reduce the amount of milk solids in ice creams by up to 25 %. Other manufacturers are expected to follow suit, where those who can be increasingly innovative will fare best in a challenging, competitive marketplace.

### Impacts on Consumer Lifestyles

The rising squeeze on raw material prices has been reflected in an increased cost to the consumer. The average price of a weekly or monthly supermarket shop has risen drastically in the last few years. In their recent report, DEFRA indicated that the weekly cost in the UK for food and grocery shopping increased by 2.2% on average, between 2005 and 2006.

It has long been publicised that the cost of food to the consumers has gone down over the years, as mass-produced foods can be produced more cheaply. Consumers are now familiar with the concept of relatively cheap foods, which may have travelled significant distances to reach the supermarket. In the case of animal products, these lower costs are made possible by sourcing meat, egg and fibre products from far-flung fields, and usually result in a reduced situation for animal welfare. The rising fossil fuel costs, and also in raw material cereal supplies, have caused increases in the price of staple food ingredients, such as bread. Milk and meat are also more expensive to produce, in direct relation to the increases in the associated commodities, so the cost of food is no longer as low as it was 3 years previously.

With increases in prices for a number of food ingredients, supermarkets have also provided a means to cut costs. Extensive research into the taste and formulation of supermarket-owned brands have been carried out over the years, and in many cases it is now very difficult to tell a manufacturer's branded product from a supermarket-owned brand. In the documentary, consumer research revealed that it was possible to save £50 on the cost of a weekly family shop by switching to one brand level lower than the previously favoured premium manufacturer brand for most products. In many cases, the reduction in costs has been made possible by outsourcing the supply of ingredients to China and India, although the quality control standards in these countries are vastly different from the situation in mainland Europe. Consumers need to be very proactive and vigilant to keep down their costs, as it is increasingly difficult to maintain low costs of grocery shopping for quality products in these changed times.

### Conclusion

The Food and Agriculture Organisation has predicted that increased costs for food production could remain for up to 10 years until 2017. The question must be asked, for how long can high prices be sustained by both industry manufacturers and consumers alike? Increasing competition for prices may prompt a shift towards a greater purchase of supermarket-owned brand products by consumers in an increasing number of food sectors, which will further hurt the margins of food industry manufacturers. Other shifts will depend on consumer behaviour, as the level of awareness over the cost of food has yet to shift. The current stranglehold on the industry appears to benefit only the supermarkets, who have still managed large increases in profit margins since the price increases began. Thus, the ultimate challenge will be to find some way of decreasing the grip of the supermarkets on an already overburdened industry, where finding other acceptable outlets for marketing food products without such an expensive middle-man are now vital.

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