

Make Informed Decisions

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Bread Price Fixing Impact?

Kevin Grier, January 2018

Introduction

As was widely reported last month, **George Weston Ltd.** and **Loblaw Companies Ltd.** announced that they had alerted the Competition Bureau of a bread price fixing scheme. George Weston Limited is a Canadian public company engaged in food processing and distribution. It operates two reportable segments, Weston Foods and Loblaw. The Weston Foods operating segment is a fresh and frozen baking company in Canada. The Loblaw operating segment, which is operated by Loblaw Companies Limited and its subsidiaries, is Canada's largest food distributor and a leading provider of drugstore, general merchandise and financial products and services.

The Weston-Loblaw announcement said they told the Bureau immediately after discovering the arrangement in March 2015. The two companies said in a joint statement that they became aware of an arrangement involving the co-ordination of retail and wholesale prices of some packaged breads from late 2001 to March 2015. They added that the participants regularly increased prices on a coordinated basis. The claim was that participants in the scheme included both companies, as well as other major grocery retailers and another bread wholesaler.

Metro Inc. said in a statement that it is cooperating with authorities involved in the price-fixing probe and that an internal investigation is underway. The Montreal-based company said there's no evidence so far that it violated the Competition Act. **Sobeys Inc.** said it doesn't believe its staff contravened the Competition Act. "Any assertion of an industry-wide price-fixing arrangement has not been proven," it added. "Sobeys will continue to fully cooperate with the Competition Bureau as it continues its investigation." (BNN.ca, December 20).

While the Competition Bureau carries on its investigation, it is of interest to assess what happened with bread and food prices over that 2001-2015 time frame. The data and analysis presented here paint a picture of a period of time in which bread prices at both the manufacturer and retail levels performed favorably for both manufacturer and retailer. Over that period of time consumers paid significantly more for bread than would have been the case had bread prices trended along the path of the total

food basket. None of that of course, is proof of anything pertaining to collusion. It simply provides a perspective on the performance of the relevant commodities over that time.

Competition Bureau Process

The Competition Bureau says it is conducting an ongoing criminal investigation into alleged anti-competitive agreements or arrangements between competitors to fix the wholesale and retail price of fresh commercial bread in Canada. It says that it is difficult to determine how long an investigation of this scale will take. The Bureau is required by law to conduct its investigations confidentially, and it has not commented on the details of this specific case.

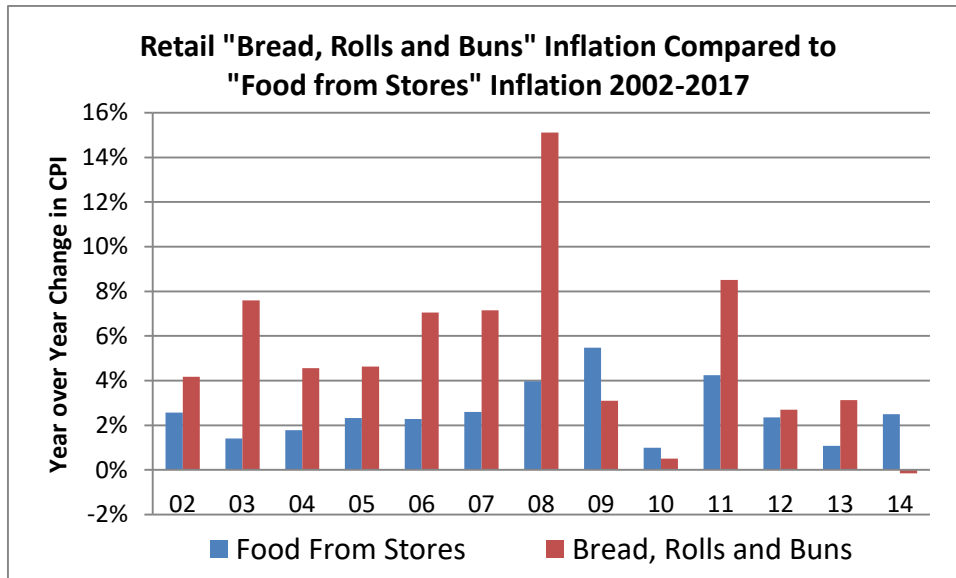
The Bureau initiates investigations as the result of information it obtains about marketplace practices that may be anti-competitive and contrary to Canada's competition laws. It can obtain information from a variety of sources, including market observations, information provided or complaints made by consumers, businesses, informants, or whistleblowers. Information may also be provided by participants in illegal activity seeking immunity from prosecution, or leniency, under the Competition Act. The Bureau says that the Immunity and Leniency programs are among the Bureau's best tools for detecting cartels. That is particularly interesting in this instance given what Loblaw and Weston have said and done.

The Bureau says it does not hesitate to take appropriate action to protect competition and consumers when it finds evidence of behaviour that violates the Competition Act. In the course of the Bureau's examinations and inquiries, investigators may interview suppliers, customers, competitors and other industry participants. The Commissioner may use a range of investigative tools to obtain evidence in an inquiry as provided under the Competition Act and under the Criminal Code of Canada (searches, production orders for records or written responses to questions, oral testimony and wiretapping). Where Bureau investigators secure sufficient evidence of an offence, the Commissioner may refer the case to the Director of Public Prosecutions for a decision on whether a prosecution will be initiated.

The Data Look Interesting

Loblaw and Weston said that the scheme took place over the late 2001 to March 2015 period. It is of interest, with regard to this issue, to look at what actually happened in the market over the full years of 2002 through 2014. This can be done by looking at publicly available data from Statistics Canada. A good place to start is the inflation rate for the product in question in comparison to food overall.

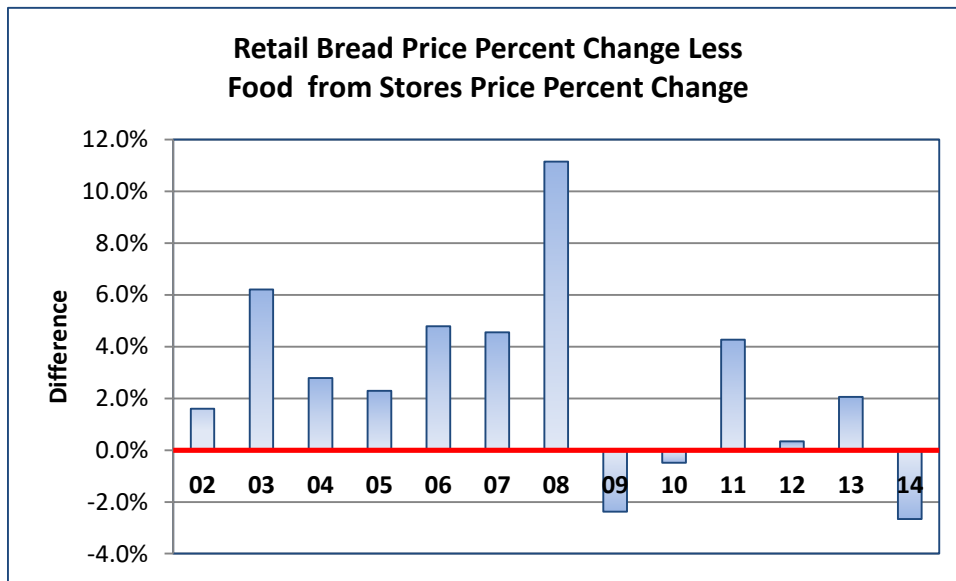
Over the 2002-2014 period, which is the core of the period in question, the Statistics Canada Consumer Price Index (CPI) for "Food from Stores" rose at an average or compound annual rate of 2.57%. That is, the annual inflation rate for food purchased from stores was 2.57%. Over that same time, the StatsCan CPI for "Bread, Rolls and Buns" rose at a compound annual rate of 5.25%. That inflation rate is more than double the "food from stores" rate. The graph below shows the food overall and bread inflation each year from 2002-2014.



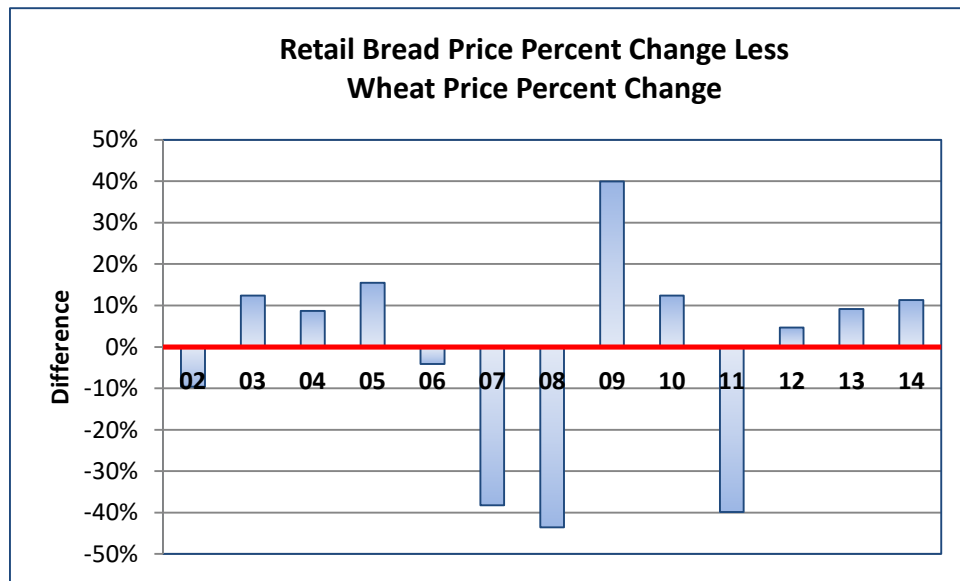
Are Ingredients to Blame?

The fact that the bread price increase was twice the food store rate was greatly aided by 2008. That was the year of significant grain and wheat price inflation due to government ethanol policies. Government ethanol policies greatly inflated the price of many food items from meat to vegetables. Those resulting wheat price increases would have pressured bread ingredient costs higher. In addition to that, there was also notable wheat crop price inflation in 2011. That also would have pressured bread ingredient costs. In other words higher ingredient costs due to ethanol and other commodity-based reasons could mean higher bread prices for consumers.

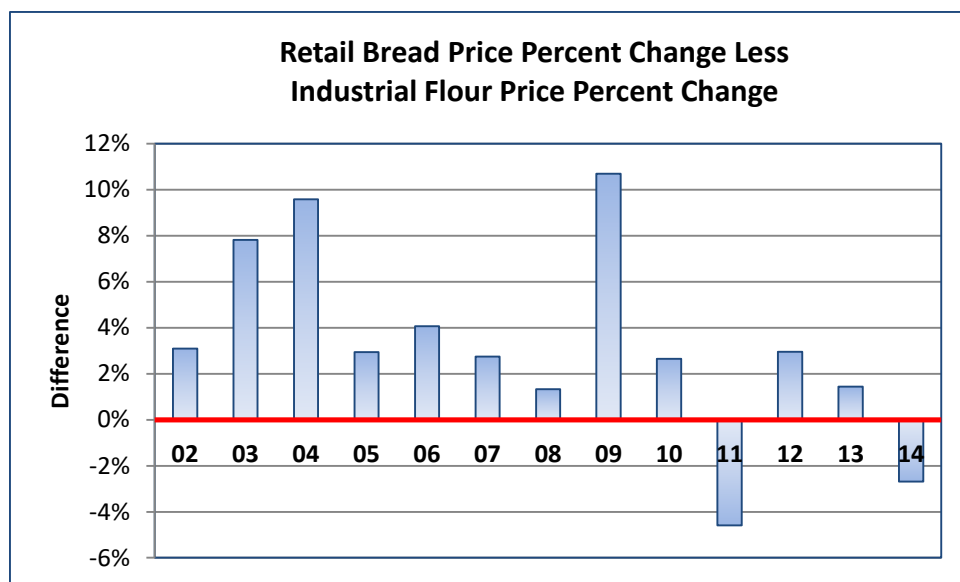
With that noted, however, it is also of great interest that in 10 of the 13 years from 2002-2014, the bread price increases exceeded the food from store price increases. As seen in the graph below, bread inflation rates were greater than overall food inflation rates in 10 of the 13 years in question.



Furthermore in nine of 13 years from 2002 to 2014, bread price increases were greater than wheat price increases. In other words, based on wheat commodity costs alone, it is difficult to say that the surge in bread prices relative to food in general was due to wheat costs.

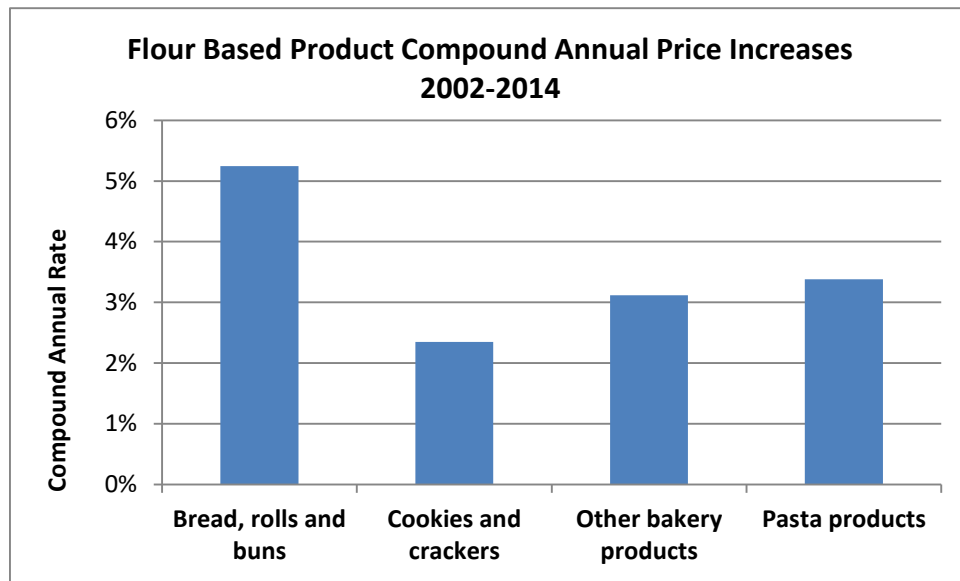


Another interesting product focused pricing performance comparison would be between consumer bread prices and industrial wheat flour. As noted above, from 2002 to 2015, bread prices increased at a compound annual rate of 5.25%. Over that same time, the StatsCan Industrial Product Price Index for Hard Spring Wheat Flour, a key ingredient in bread, increased by 1.9% annually. In only two of the 13 years did the bread price increase at a slower rate than the industrial wheat flour. Again, it is difficult to pin the increases in bread prices on ingredient pressures.



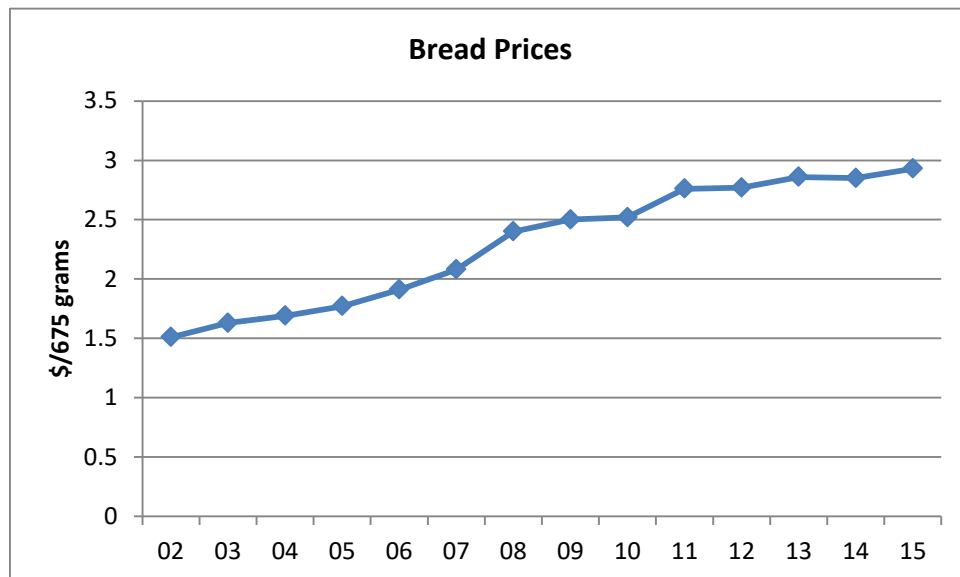
Lastly, with regard to the ingredient issue and prices, it is relevant to compare the price increases of other flour-based products to that of bread. In that regard if the price increases of other flour-based

products such as cookies and pasta are based on ingredients, then there should be similar gains compared to bread. That is not the case. Bread price increases greatly exceeded the increases in prices of cookies and crackers, pasta products and others.



Bread Prices Soared

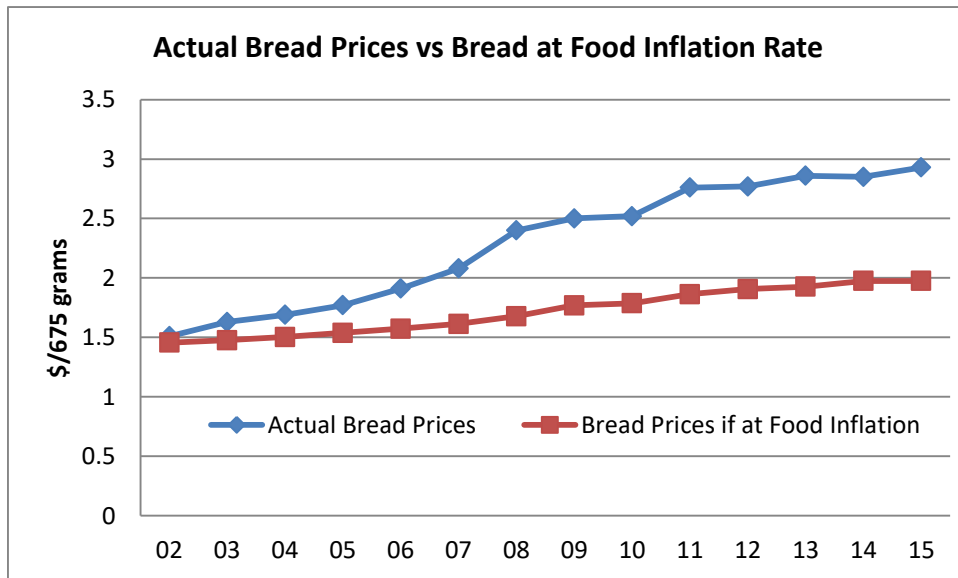
With regard to actual bread prices, as opposed to bread inflation rates, the Statistics Canada tracking of bread prices over the 2002 to 2015 period shows that prices nearly doubled over that period of time. The average price of a loaf in 2002 was about \$1.50 compared to \$2.93 for the 2015 average.



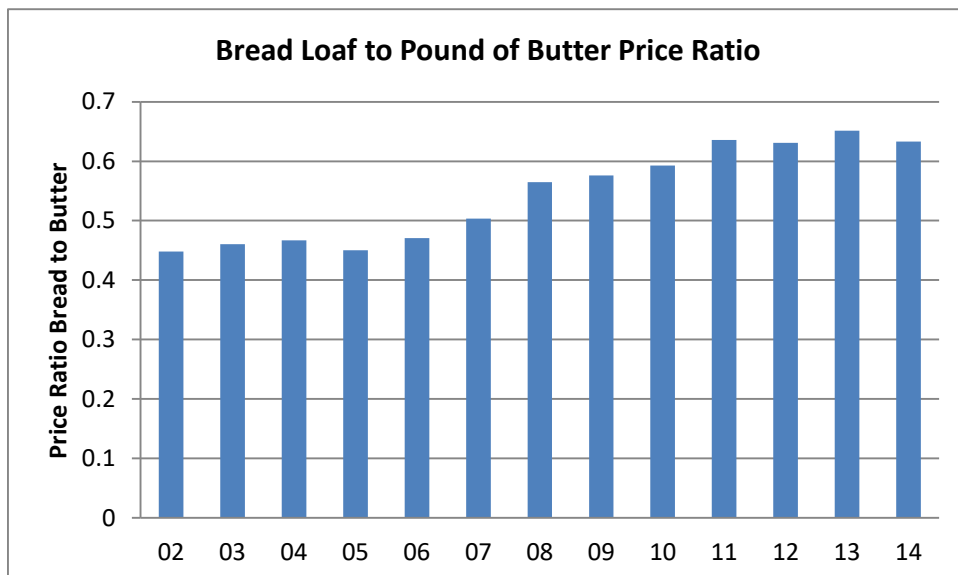
It is particularly interesting to compare the actual bread price performance to what it would have been if bread only increased at the rate of food inflation. By 2015 a loaf of bread cost nearly \$1.00 more than it would have cost had prices risen simply at the rate of food from stores inflation. From 2002 to 2014 the

average price difference was \$0.55 cents. The increased rate of bread inflation cost consumers much more than if bread prices had moved along with the food path.

Jason Markusoff noted in an excellent January 11, 2018 MacLeans.ca article that using the \$1 gap between the real bread price and the food inflation bread price, if a family buys one bagged bread per week for a year, that's a \$52 difference. Using the average price gap from 2002 to 2014, 55 cents, "that one loaf per week over that period may have plumped up a grocery bill by \$371.80," says Markusoff. That helps provide some perspective on Loblaw's offer of a \$25 gift card as a goodwill gesture pertaining to the price fixing issue.



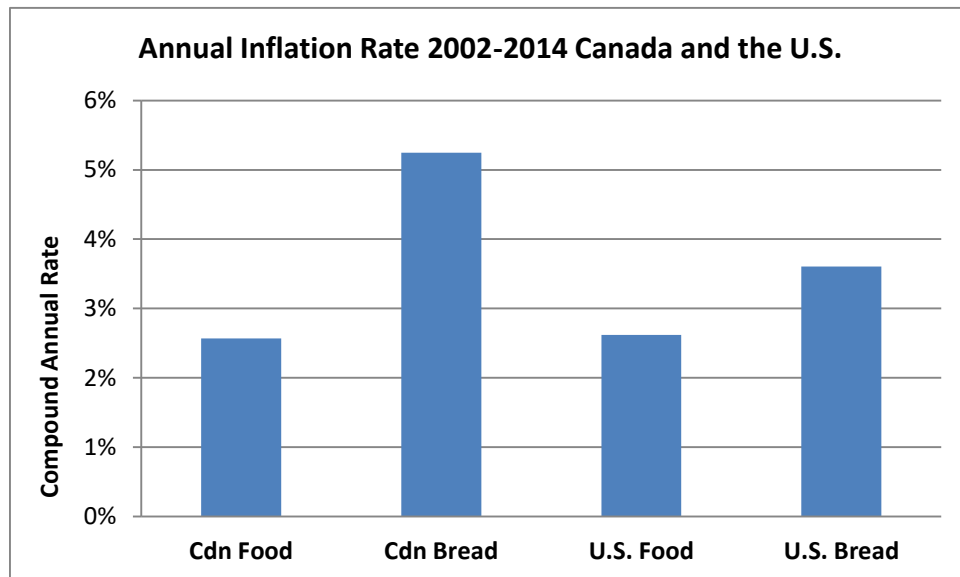
Another way to look at the bread pricing performance is to look at butter, the best spread for bread. Butter increased in price from \$3.37 per pound to \$4.50 from 2002 to 2014. That butter change was an increase of just 34% compared to 89% for bread. In 2002 a loaf of bread was valued at 45% of a pound of butter. By 2014 bread was worth 63% of a pound of butter.



Comparisons to the U.S.

It is usually useful to compare market performance in Canada to the United States. Given the similarities in the two markets generally, it can be instructive to see divergences, if any.

Over the 2002 through 2014 period, while Canadian food from store inflation increased at a compound annual rate of 2.57%, the U.S. food at home compound annual rate was 2.62%. In the meantime over that time while bread, rolls and buns in Canada were increasing at a 5.25% rate, the U.S. bread compound rate of increase was just 3.6%. If all food is the benchmark in the U.S., there was virtually no difference between Canada and the U.S. Bread on the other hand stands out as a stark divergence from the U.S.

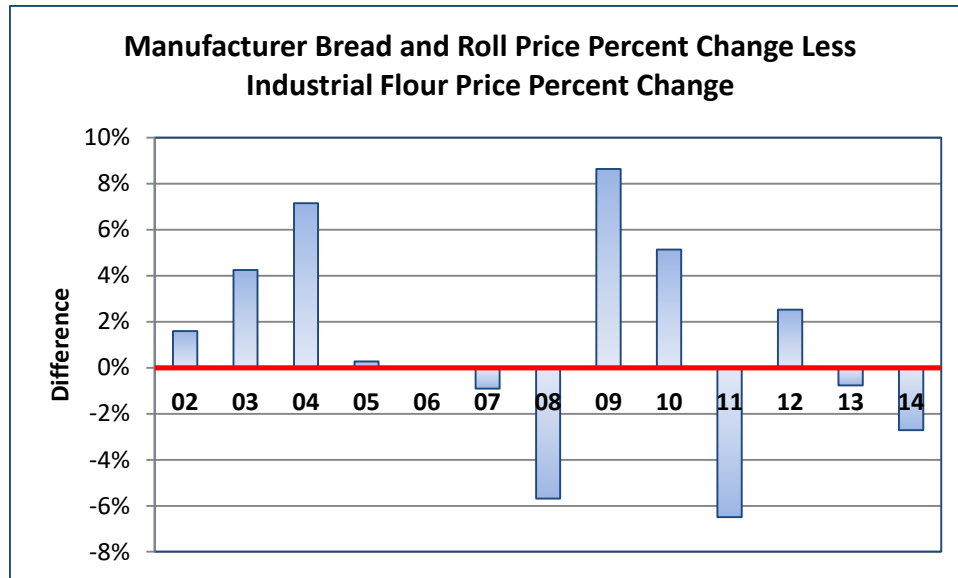


Bread Manufacturing Sales Inflated?

Canadian bread and bakery product manufacturing sales are probably going to be about \$7.6 billion in 2017, an increase of about 3-4% over 2016. Over the 2002-2014 time frame in which the collusion was said to have occurred, bread and bakery product manufacturing sales increased at a 5% compound annual rate. That compares to a 3% rate for all food manufacturing over that time.

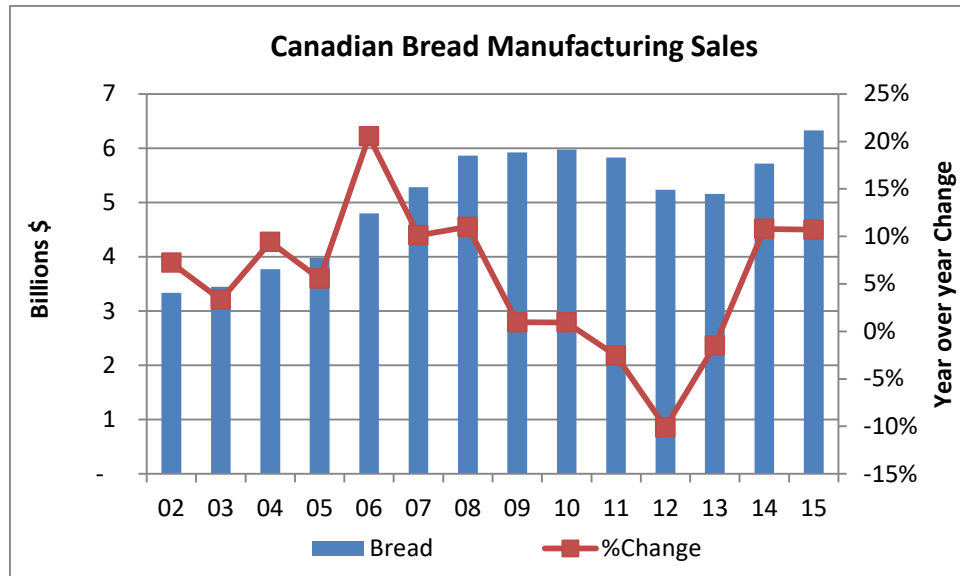
Hard spring wheat flour is a principle ingredient in bread. As noted above, the StatsCan Industrial Product Price Index for Hard Spring Wheat Flour, increased by 1.9% annually. Statistics Canada also tracks the prices of a category called “Bread, rolls and flatbreads” at the manufacturer level. That is it tracks the prices that bakery manufacturers such as Weston could have received for the sales of bread, rolls and flatbreads. It does not separate bread prices alone.

Over the thirteen year time period in question while the flour was increasing at 1.9% annually the prices of bread, rolls and flatbreads were increasing at a rate of 3% at the baker level. In eight of the thirteen years, the bread wholesale price rose faster than the ingredient price. Regardless of what other cost pressure were happening at the manufacturer level, it is clear that manufacturers were increasing their price margins over the flour ingredient costs.



If there was bread price fixing at retail or manufacturing or both, it probably, but not necessarily, inflated the total sales of bread in Canada. Whether it actually impacted sales and ultimately profits would depend on the elasticity of demand for the product. If bread demand was inelastic, consumers might simply purchase bread regardless of price. That should increase sales and profits. If bread demand is elastic, that implies that consumers tend to be sensitive to price. In that case price increases might actually result in lower sales and perhaps profits.

Again, if bread demand was, or is inelastic, people would have bought bread somewhat regardless of the increases. Based on the graph below of manufacturing sales, there is reason to argue that bread demand was inelastic over the 2002 to 2008 period. Despite the price increases at retail, total sales kept rising over that 2002-2008 period. Looking again at the graph below, it can be argued that bread demand weakened in 2008 through 2014. During that time, there might have been non-price factors negatively impacting demand for bread. A growing desire to reduce carbs from grains may have come into play over that time. If there was price fixing over that time it may have even contributed to lower sales and profits for manufacturers. If there was price fixing, this would have been a less advantageous period for the practice.



Summary

It is important to note that none of the data or analysis presented above is proof of price fixing or collusion. The data and analysis provide an assessment of what was happening statistically over the period time in which the price fixing was said to have taken place.

With that said, the data and analysis do paint a picture of a period of time in which bread prices at both manufacturer and retailer level performed favorably for both manufacturer and retailer. Bread prices stand out uniquely in Canada against other products and against the performance in the United States. Over that period of time consumers paid significantly more for bread than would have been the case had bread prices trended along the path of the total food basket.

Why it Matters

If bread price fixing actually happened as Weston says, it is a black mark for the entire food industry. It hurts the integrity and perception of the entire industry. Skeptical and jaded consumers are going to be more skeptical and jaded about the industry, and that is understandable. Companies in all industries at retail and manufacturing are all going to pay the price because consumers are going to be more focused on price than ever before.

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