

Canadian Food Manufacturers Competitiveness Erosion Continues In 2012

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This paper examines the competitive status and the challenges faced by Canadian food processing industry. The paper surveys the stress that the industry is under from a trade and profit perspective. Its purpose is to explore the factors that are causing the competitive stress and to continue the debate regarding the steps necessary to address the challenges.

As a starting point, a good working definition of competitiveness is the ability to profitably maintain or enhance market share. Based on that definition, it appears that this important industry is under increasing competitive pressure from both a market share and profit standpoint.

Trade Share Erosion

Based on preliminary data from the US Foreign Agricultural Service (FAS), Canada's trade deficit with the US in processed foods will hit a new record in 2012. For the purposes of this discussion, where processed foods are defined as manufactured consumer oriented products and do not include fresh meats or poultry. Canada will import about US\$9.2 billion while exporting only US\$7.7 billion to bring the deficit to \$1.5 billion (Figure 1). That compares to a trade surplus of nearly \$0.9 billion in 2004, a decline of over 1.5 times.

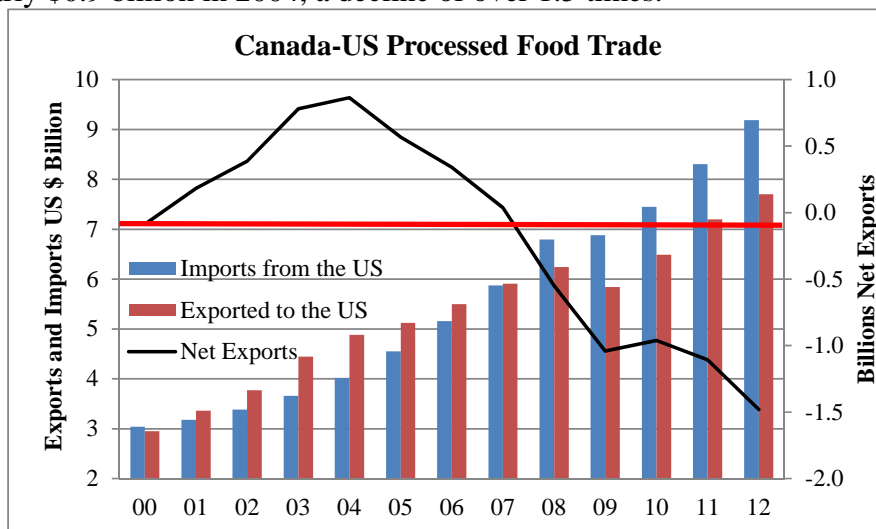


Figure 1

Within the umbrella of processed food, there are of course a variety of products ranging from canned vegetables to snack foods to cereal. The grand total shown in Figure 1 demonstrates serious erosion; however, each commodity within that overall grouping exhibits its own trends.

For example canned and frozen vegetables comprise an important component of the processed trade. The trends in that sector are different than the overall trend (Figure 2). Canada has consistently enjoyed a surplus in processed vegetable trade with the US, reaching an estimated record of nearly US\$0.8 billion in 2012 according to FAS data. That is nearly double the surplus in 2000.

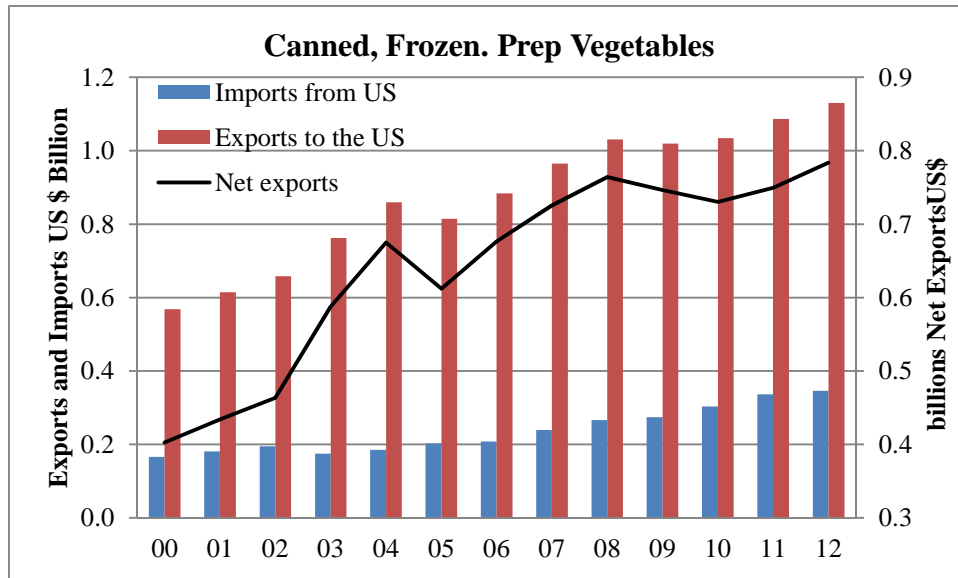


Figure 2

Meanwhile, cereal foods, pastas and other milled products reveal a mixed message. While Canada is in a surplus position with the US in these products, its trade position is eroding rapidly (Figure 3).

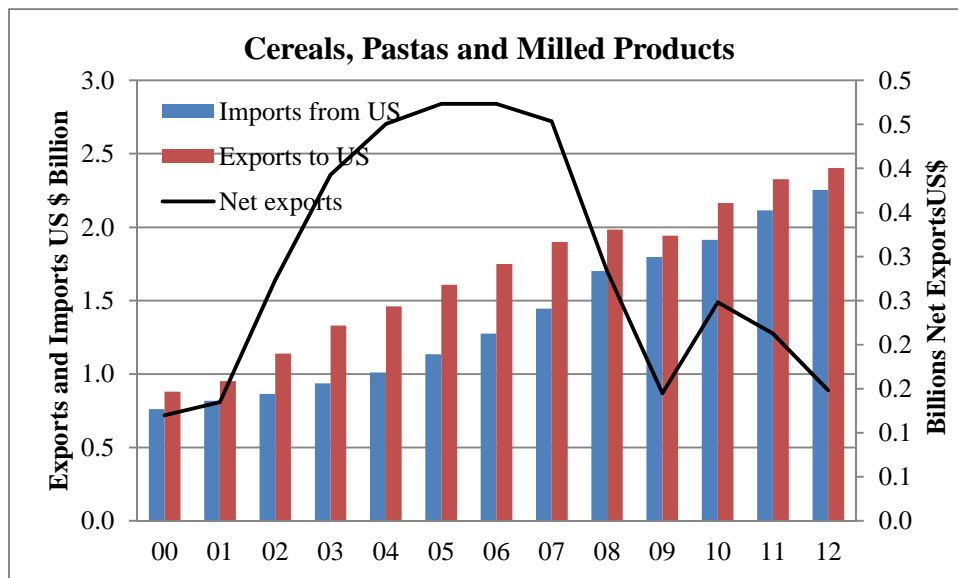


Figure 3

As another example, products such as sauces, ketchup and soup demonstrate trend patterns that are more similar to the overall broad processed category (Figure 4).

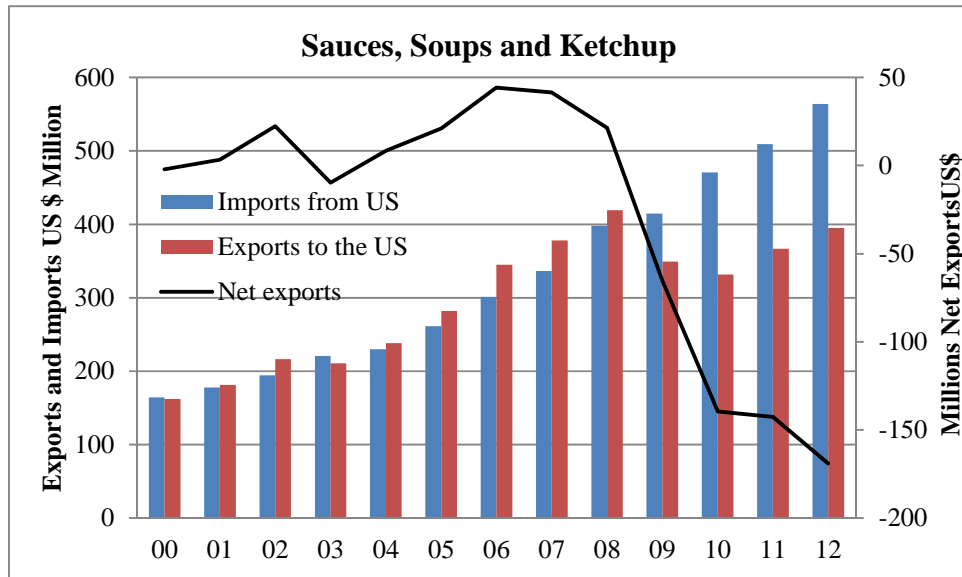


Figure 4

The message is that within the generalized pattern of lost market share in Canada and the US, each industry has its own trade patterns and differing circumstances. It is the general trend that suggests concern but each industry has its own results and competitive outcomes.

With that noted, the question is why is Canada losing the North American food market share battle with the US? This is a similar type of question asked by the Canadian Agri-food Policy Institute (CAPI) in a paper released last fall. CAPI noted that in total global trade, Canada's net trade in value-added processed food has deteriorated from a deficit of about \$1 billion in 2004 to \$6.3 billion in 2011. While Canadian processed food exports stalled over this period, imports rose steadily.

Exposed by the C\$

The obvious starting point is the appreciation of the Canadian dollar. The impact of the C\$ on Canadian imports and exports is stark. The appreciation lowers the cost of imports and reduces export returns.

For example last year, the value of Canadian imports of US tomato juice was about C\$900 per thousand litres. In 2005, the Canadian dollar averaged about 0.83 US cents. If the exchange rate had stayed at that level, the value of that same imported tomato juice would have been about C\$1,100 per thousand litres (Figure 5). The appreciation makes the US product more of a competitive challenge to local product.

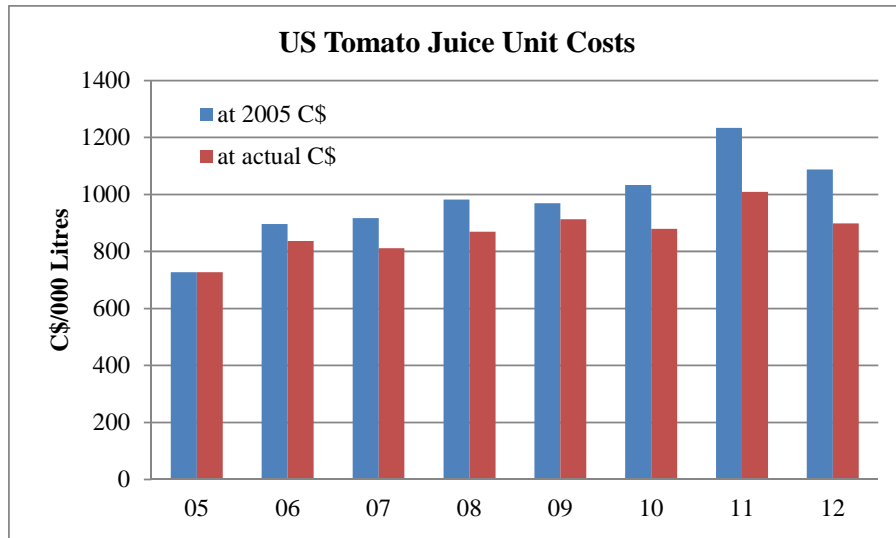


Figure 5

Conversely, Canadian exports of tomato juice brought back just over C\$900 per thousand litres last year. As with the imports noted above, at a 2005 C\$, the returns would have been nearly C\$1,100 per thousand litres. At the very least the appreciation reduces potential C\$ returns and at worst, it exposes a higher cost structure. That is, the US might be a profitable destination at C\$1,100 but not at \$900.

Further to that cost structure issue, wage differentials are often identified as a Canadian culprit in Canada's competitiveness woes. With that noted, however, prior to the appreciation of the C\$, Canada looked very competitive with regard to wages. From 2002-2005, Canada's Statistics Canada employment data shows that food manufacturing wages amounted to about \$15.50/hour in Canadian dollars or just \$11.49/hour in US dollars. For comparison, US wages in the food industry over the same time were nearly \$13/hour according to the Bureau of Labor Statistics, giving Canada a wage advantage in US dollars.

During the three years from 2010 through 2012, Canadian wages in Canadian and US dollars have been roughly the same at about \$18/hour. Given the near par dollar there is little or no differential in a Cdn or US exchange conversion. US wages on the other hand were just \$14.70/hour. As such over the decade, Canada has gone from a wage advantage of well over a dollar US\$ to a wage disadvantage of well over \$3/hour US\$ (Figure 6)

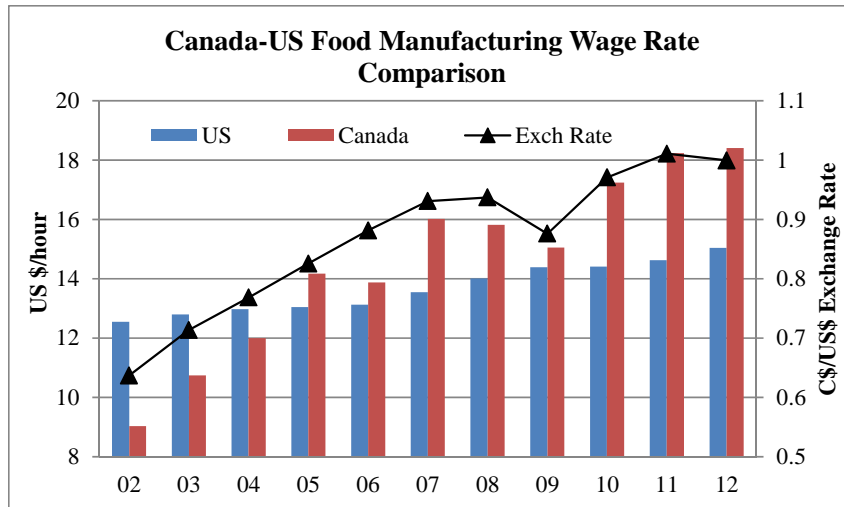


Figure 6

Productivity Challenges

The challenge Canadian food manufacturers face is not simply the wage differential but also in the area of productivity. In 2002, the US averaged about US\$300,000 in food manufacturing sales per employee. By 2012 that total had grown to \$500,000 dollars per employee. In Canada in 2002 the sales per employee were C\$275,000. That compares to C\$383,000 by 2012 (Figure 7). The US sales per employee grew by 66% compared to Canadian growth of just 39%.

Interestingly, employment in the food industry has declined in both Canada and the US from 2002 to 2012. US employment in the food industry declined by 4% since 2002, while Canadian employment declined by 6% (Figure 8).

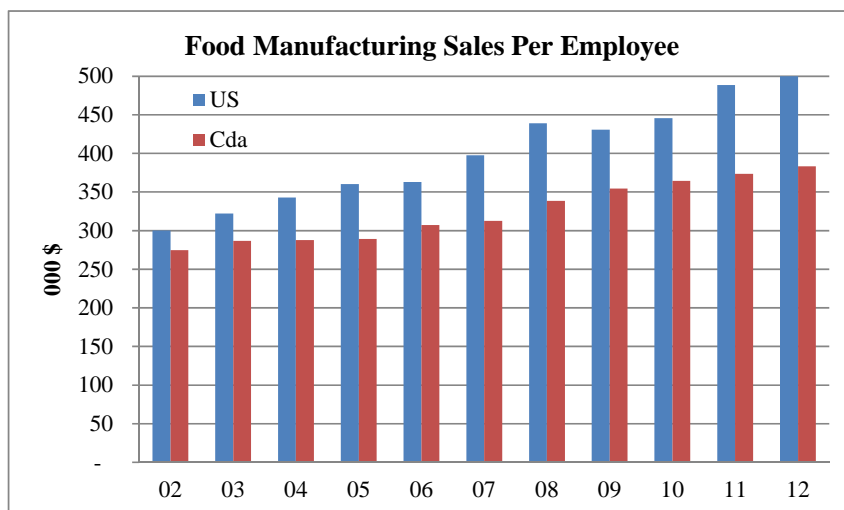


Figure 7

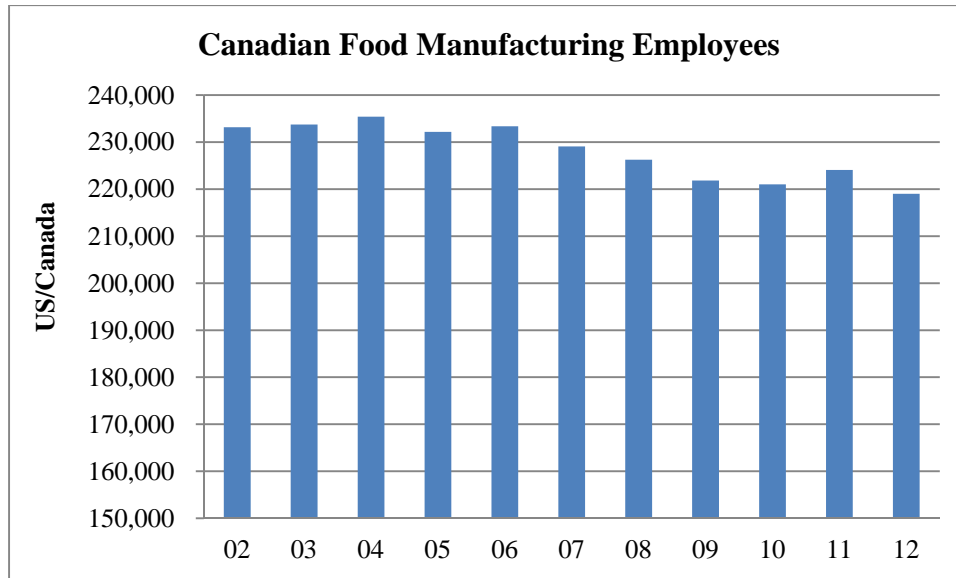


Figure 8

The US growth in Canadian market share has occurred in tandem with its growth overall in comparison to Canadian food manufacturing. That is, US food manufacturing is growing much faster than Canadian food manufacturing. From 2002 to 2012, Canadian food manufacturing sales grew by over 30%, whereas US food manufacturing grew by nearly 60% (double the Canadian rate). In 2002, the US industry was about 7 times larger than the Canadian industry; and by 2012, the US industry was more than 8.5 times greater (Figure 9).

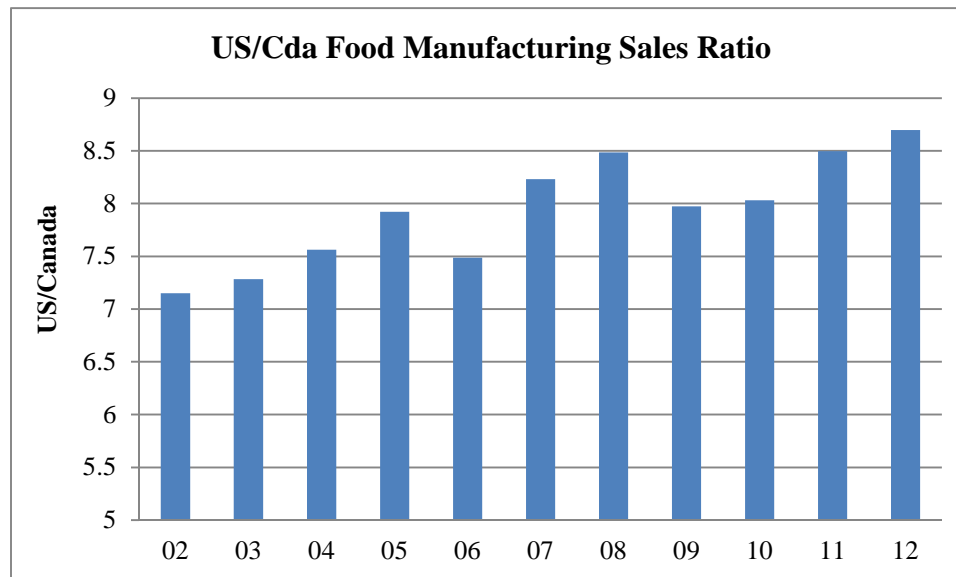


Figure 9

Not surprisingly, as Canada loses ground in both the US and Canada, it is also becoming a relatively smaller industry and a smaller employer.

Food Manufacturer Returns Struggle

As noted at the start of this paper, a good definition of competitiveness is the ability to profitably maintain or enhance market share. As can be seen from the above, Canada is having its market share problems. Based on the margin data, Canada is having its profitability challenges as well.

Statistics Canada recently released its third quarter profit report for enterprises. The data showed that food manufacturers saw sharp declines in profits during the third quarter of 2012. The 14% decline in operating profits was the fifth straight quarterly profit decline for food manufactures. On a year to date basis through the third quarter, operating profits have declined by 8% compared to the first three quarters of 2011. The graph below shows a choppy downward trend in operating profit since mid-2009.

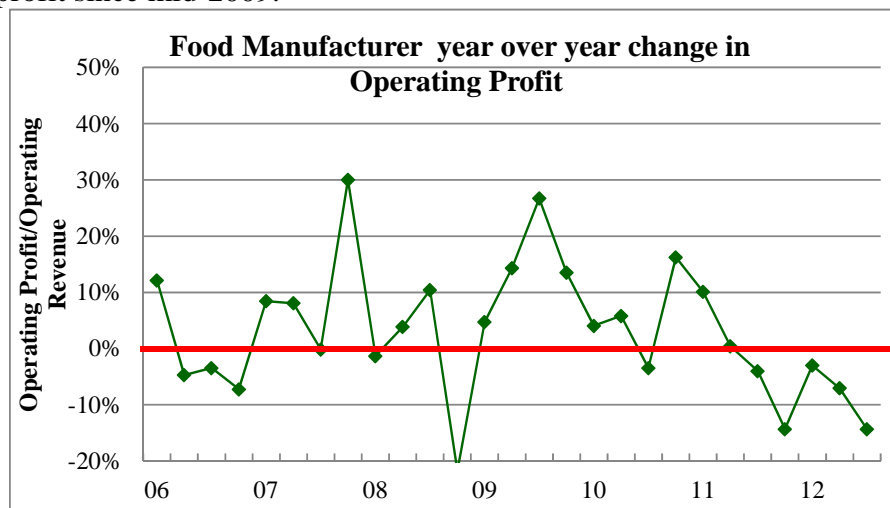


Figure 10

With regard to the apparent eroding trend in food manufacturing profits, the explanation appears to be the dramatic increase in raw material costs. Food manufacturers have not been able to pass along the increases in raw material costs that they have had to absorb since 2007 and in particular since the beginning of 2009. The following graph shows the Industry price indexes for finished foods compared to a raw product index. The raw product index combines the raw materials price index for vegetable/grains, animal products and total raw materials.

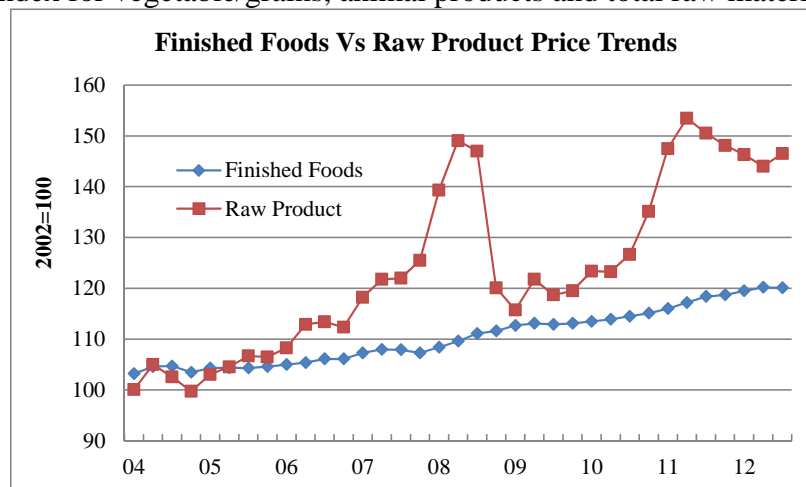


Figure 11

Since the beginning of 2009, total raw food stuffs and other raw materials costs have increased by 27% while the prices of finished foods increased only 6.5%. Manufacturers' struggle to pass along cost increases is shown on their margin returns.

The bottom line is that the last ten years have seen erosion in the Canadian food industry from a variety of fronts and for a variety of reasons. Clearly there is a wide variety of competitive challenges that are causing the industry to erode in sales, market share and employment, both domestically and in North America.

Steps Forward

Ultimately it is individual companies that compete within the opportunities or constraints presented by provincial or federal fiscal and regulatory parameters. Canadian firm competitiveness or lack of in the food industry has been exposed by the par dollar. Individual firms, are either taking the steps to adjust to the par dollar, or are winding down and returning to their US base. Maple Leaf Foods for example has taken steps to adjust its plant size and scale to the reality of the par dollar. It has made it clear that it believes the only way to survive and grow is to meet US and global competitors with both scale and product development. This is not to say that only massive size companies and plants can compete. With the cost structure exposed, however, the competitive challenge for small to mid-sized firms is one of delivering added value or innovation to buyers.

Canada's fiscal and regulatory parameters have also come under greater scrutiny in light of the par dollar. In the last five years, federal and provincial governments tried to show their commitments to food industry competitiveness through grants and loans. Alberta's ALMA program and the Federal Government's AgriProcessing Initiative are two examples. Given the results so far, it suggests that federal and provincial governments need to put their efforts elsewhere. Questions regarding the impact of fiscal and regulatory impacts on competitiveness need to be answered, or better yet, at least asked.

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