“The Performance of Canada’s Food Manufacturing Industry” – Revisited

By: Kevin Grier, Senior Market Analyst
March 2014

Introduction

The Ivey School of Business Processed Food Research Program and the Canadian Agri-Food Policy Institute (CAPI) recently released a report entitled, “The Performance of Canada’s Food Manufacturing Industry.” The report contained nine “Key Findings” regarding the state of the industry. The nine findings related to the changing employment structure, investment, sales growth and profit. Each of the findings was accurate and well documented.

With that noted, media reports have tended to focus on findings #3 and #7 related to the industry’s profits and sales growth. These two findings paint a relatively positive picture of the state of the food manufacturing industry. The issue, however, is that the Ivey data analysis ends in 2011; in the years since the situation has changed. Therefore the media has missed the fact that this change has occurred.

The following is a response to some of the findings that appeared to be of most interest to the general media. The findings in question are italicized and followed by a commentary and response to the finding.

Key Findings and Response

Finding #3

“Food manufacturing is different. During the recent recession food manufacturers faced similar challenges to other industries but food industry performance was much different. Food manufacturing proved to be remarkably resilient in both revenue and employment compared to other manufacturing industries.”

Response to Finding #3

This finding is correct. The data shows that during the recession of 2009, the general manufacturing sector lost sales of about 17%, while food industry sales continued its normal course of growth. In other words the food industry appeared to be unaffected by the recession while overall manufacturing was hit hard.

As a starting point, and as a general observation, the fact that the food industry did not lose sales while general manufacturing declined should not be surprising. The food industry is often described as “recession-proof.” The food industry sells non-discretionary items. Consumers must continue to eat during a recession. At the same time, during a recession consumers put off spending on discretionary items such as cars, furniture, clothes and appliances among many other things.

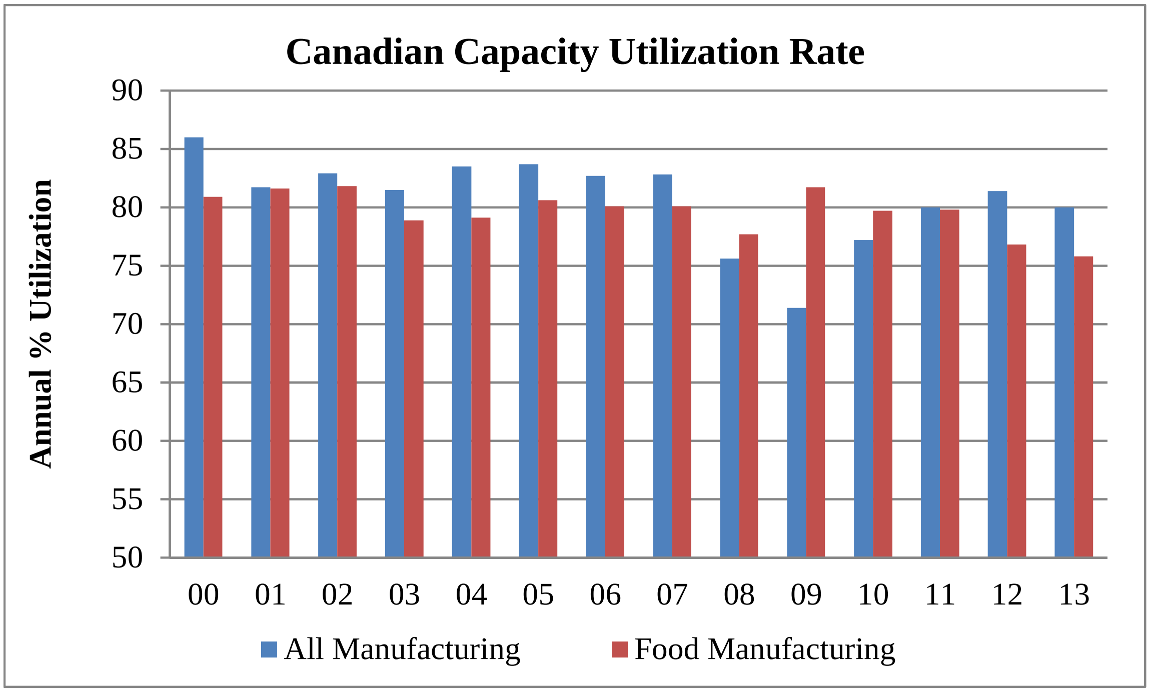
Beyond that general observation, however, other aspects of the Finding need to be assessed in greater detail post 2011.

First, it is to be noted that according to Statistics Canada data in 2013, Canada’s food manufacturing industry represents about 13-14% of total manufacturing in Canada. That is down from the recession year of 2009’s high of over 15% but well above the pre-recession average of 10-11%. Clearly food manufacturing gained share during and immediately after the recession due to the contrasting natures of total manufacturing and food manufacturing. Again, during a recession, food manufacturing is less impacted than other industries. As such while food would be adversely influenced by a recession its negative influence is less than that of most other industries. With that noted, the food industry has been losing share of total manufacturing since its recessionary peak.

Sales growth differentials are the drivers of share changes. In that regard, during the five years after the recession from 2009-2013, the sales of the total manufacturing sector grew at a compound annual rate of five percent compared to just two percent for food manufacturing. So while food manufacturing, as could be logically expected, is less impacted by the recession, its relative growth has been slow during the recovery, compared to total manufacturing.

Employment is another key measure mentioned in the Ivey report. According to Statistics Canada since the recession from 2009-2013 food manufacturing employment has declined by 1% compared to 0% change for all manufacturing.

More importantly, a key barometer of an industry’s state is capacity utilization. The rates of capacity use are measures of the intensity with which industries use their production capacity. Capacity use is the percentage of actual to potential output. It is noted that food manufacturing capacity utilization rates have been declining sharply since the recession. That stands in contrast to overall manufacturing which has been recovering. According to Statistics Canada data, food manufacturing capacity utilization declined to an average of just under 76% in 2013 compared to nearly 82% in 2009 during the recession. By contrast total manufacturing struggled with an exceptionally low rate of utilization of 71% during the recession. Total manufacturing utilization recovered to 80% in 2013.



Source: Statistics Canada Table 028-0002

The point is that declining capacity utilization is often symptomatic of an industry facing serious challenges. The food industry has seen its utilization rate decline since 2011. That suggests that the industry is undergoing negative pressures, which in turn is supported by the sales, share and employment performance.

Finding #7

"In spite of the challenges, the Canadian food manufacturing industry managed to make gains of over 20% in both margins and net income which is greater than the rate of inflation over that 2004-2011 period of roughly 14%."

Response to Finding #7

The report also says the following:

> *Although the food manufacturing industry has shown remarkable resilience, food companies are under margin pressure. Material input costs, measured by the farm product price index (FPPI), rose 32% from 2004-2011. During that same period, the industrial product price index for food (IPPI) increased only 12.8%. Farm products make up the majority of input costs for food manufacturers, but the impact of increases in other input costs such as energy and water cannot be overlooked. The rate of increase for both*

farm product and food industry prices was still much lower than the broader Raw Material Price Index (RMPI).

There is a contradiction between the finding's growth of income compared to the performance of raw cost and food price indexes. This is noteworthy because faster growth of costs over prices does not normally lead to steady profits in an industry. It would intuitively suggest lower profits.

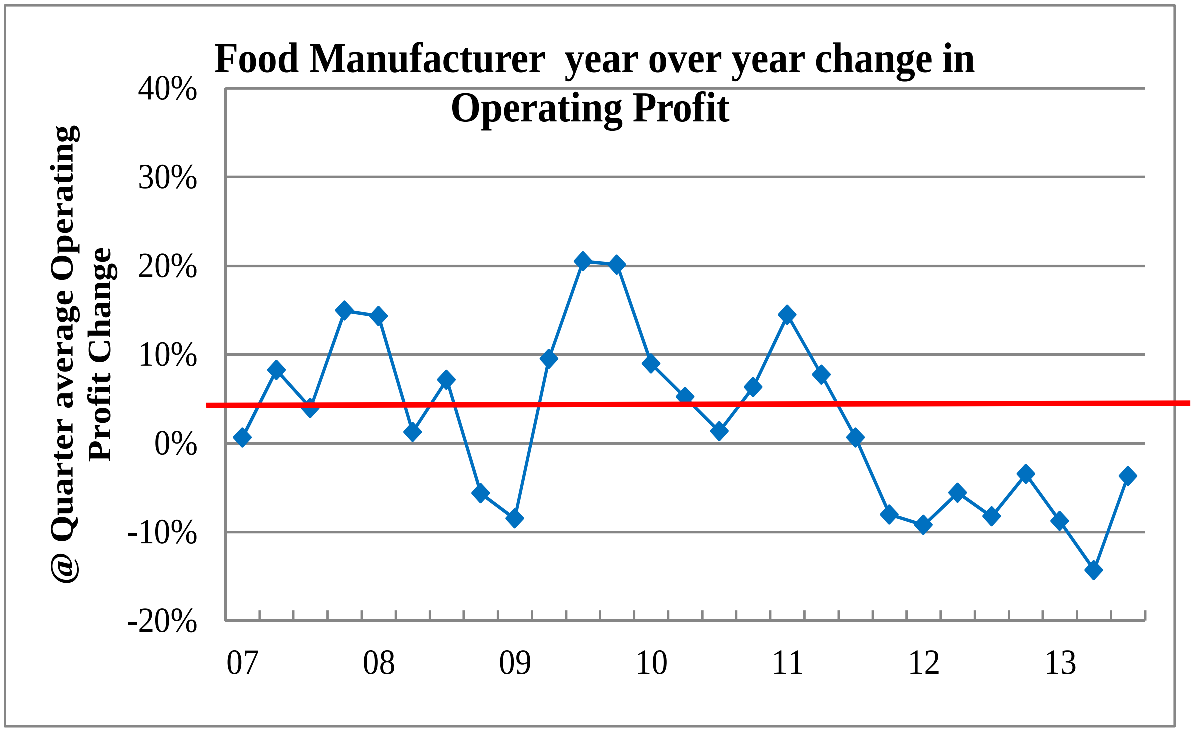
One reason why margins might have gained may be due to improved productivity. In fact the report notes the following:

"Cost of materials' is deflated by the farm product price index to reveal increasing input prices led the industry to buy less, spending almost $4.5-billion less on materials in 2011 than 2004. This result may be an indication of a shrinking population of food manufacturers in Canada or a growing level of efficiency and process innovation permitting companies to do more with less. Regardless of the reason, there will be significant impact on the upstream suppliers which in many cases are the local primary producers.

In other words the implication is that food manufacturers are cutting costs by buying less or improving efficiency. The efficiency argument is augmented by the fact that the report shows increased investment in equipment. This increase in efficiency and frugality in purchases is positive for manufacturers but it is symptomatic of underlying challenges as opposed to a result of strong profit and market opportunities. As the report notes it is also an indication of pressure on Canadian producers that supply the manufacturers.

Profits and margins could also be protected by the fact that less and less is manufactured in Canada by the food companies. Other studies have shown the finished goods have been increasingly brought into Canada from the US. This could also augment the manufacturer's margins.

In any event, the study's income analysis ends in 2011. Since that time there has been erosion in food industry profits. In fact, data from Statistics Canada's Industrial Organization and Finance Division shows that the food manufacturing industry has seen declining year over year profits since 2011. The year over year change in operating profits on a quarterly basis, (averaged over two quarters for smoothing), shows that since mid-2011, food manufacturing operating profits have declined.



Source: Statistics Canada Industrial Organization and Finance Division

Declining year over year profits and an overall downtrend since 2009 is not an indication of an industry that is making profit and margin gains. In fact it is symptomatic of an industry under increasing pressure.

Summary

The data from 2011 to 2013 on food manufacturing sales, profits and employment show that the situation has eroded. The industry has lost ground either nominally or relatively in all three areas since that time. The point is that while the Ivey-CAPI report brought forth good insight into the sector, more recent data shows that change can occur quickly. As such, generally positive reports in the media on the industry may need to be updated.

Further insights into Canada's food manufacturing and grocery industry can be gained from the George Morris Centre publication, Grocery Trade Review. For a free two month trial please e-mail Kevin Grier at Kevin@georgemorris.org