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INDUSTRY PROFILE

Industry, Science and Technology Canada
Industrie, Sciences et Technologie Canada

Confectionery

Canada

I N D U S T R Y

P R O F I L E

CONFECTIONERY

1988

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FOREWORD

In a rapidly changing global trade environment, the international competitiveness of Canadian industry is the key to survival and growth. This Industry Profile is one of a series of papers which assess, in a summary form, the current competitiveness of Canada's industrial sectors, taking into account technological and other key factors, and changes anticipated under the Canada-U.S. Free Trade Agreement. Industry participants were consulted in the preparation of the papers.

The series is being published as steps are being taken to create the new Department of Industry, Science and Technology from the consolidation of the Department of Regional Industrial Expansion and the Ministry of State for Science and Technology. It is my intention that the series will be updated on a regular basis and continue to be a product of the new department. I sincerely hope that these profiles will be informative to those interested in Canadian industrial development and serve as a basis for discussion of industrial trends, prospects and strategic directions.

Robert de Cotret

Minister

1. Structure and Performance

Structure

This industry comprises manufacturers of all types of sugar confectionery, chocolates and other cocoa-based products, as well as the producers of chewing gum. Total shipments in 1986 (the most recent statistical year) were valued at $986 million. The major industry products and the proportion of total shipments they represent, include: chocolate bars, about 30 percent; boxed or bulk chocolates, about 15 percent; hard and soft candies, 25 percent; and chewing gum, 20 percent.

In 1986, the 107 plants in the sugar and chocolate confectionery sub-sector, employed 6795 persons and shipped products valued at $759.9 million. The chewing gum sub-sector had six establishments, employed 2113 persons and shipped products worth $225.9 million.

Most chocolate operations are large and dedicated to two major products: boxed chocolates and bar chocolates. On average, companies in hard and soft candy are small or mid-sized and tend to produce for specialty or novelty markets (gummy bears, licorice, jujubes or toffee). Many also purchase domestic products or imports for resale under their own labels or to complement their lines. Chewing gum firms also manufacture other confectionery goods or novelty items (chewing gum with theme cards).

Imports are sizable and, in 1986, were worth more than $264 million, representing about 23.6 percent of the Canadian market. In 1987, they rose in value to $278 million. Foreign products come mainly from the United States (39 percent) and European countries such as Switzerland, the Federal Republic of Germany, the United Kingdom and Belgium (about 50 percent). Most of the premium-quality boxed chocolates come from Europe. Hard candy imports also originate from these countries and, increasingly, from new suppliers such as Brazil.

Exports have helped to keep production volumes up as they have increased from 5.9 percent of shipments in 1982 to 13.2 percent in 1986. Exports were valued at $130 million in 1986, 97 percent of which went to the United States. Thus, in 1986, the balance of trade with the United States was significantly in Canada's favour, despite that fact that there continues to be an overall trade deficit in confectionery.

The bulk of confectionery is produced in Ontario, which accounts for about 70 percent of total employment and 72 percent of industry shipments. Quebec follows, with 18 percent of employment and 19 percent of shipments.

Production facilities range in size from small, one- and two-person, seasonal operations to several plants each employing approximately 1000 people. Because many small operations are seasonal (Christmas, Easter, Valentine's Day), they often experience labour shortages in peak periods. In 1986, operations with fewer than 20 employees accounted for 66 percent of total establishments, but only about five percent of the industry's employment and three percent of its shipments. On the other hand, about 68 percent of total industry employment is shared among 12 percent of establishments, which, in turn, contribute 85 percent of total shipments.

Canada

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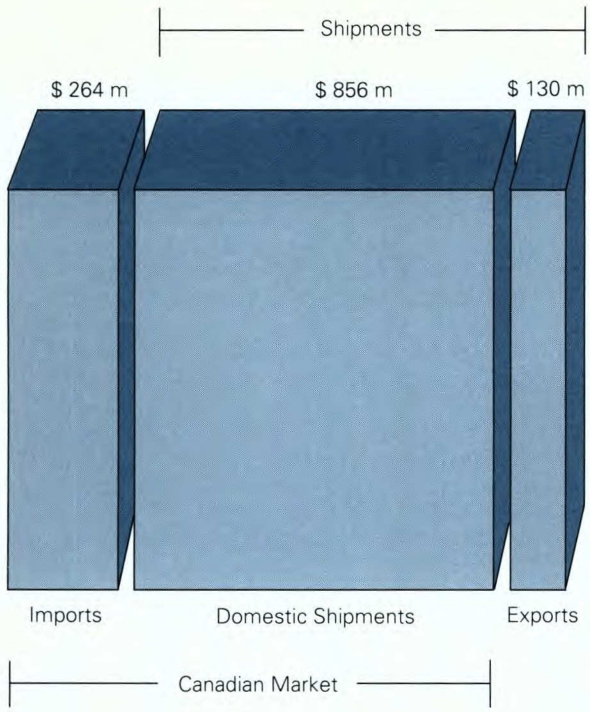


Imports, Exports and Domestic Shipments 1986

One of the largest firms is William Neilson Limited, a domestically owned enterprise. Other smaller, Canadian-owned producers include Dare Foods Limited, Ganong Bros. Ltd., Kerr Bros. Limited and Allan Candy Ltd.

Foreign ownership is high as multinational enterprises (MNEs) have a major position in the industry. An estimated 60 percent of industry shipments are accounted for by foreign-controlled Canadian enterprises. Many major companies are recognizable subsidiaries of foreign-based MNEs — Hershey Canada Inc., Rowntree MacIntosh Canada Ltd., Effem Canada Ltd., Wrigley Canada Inc. and Warner-Lambert Canada Inc.

Performance

Industry performance is influenced by its ability to achieve high rates of production, as well as by competition from imports and the fluctuating cost of some agricultural raw materials.

Total shipments, worth $986 million in 1986, represented a seven-percent increase in value over 1982. When adjusted for inflation, however, shipments show a decrease in real terms of about 13 percent. In recent years, demand for many domestic confectionery products has decreased slightly. In part, this drop is due to the lower proportion of children in the population and to a growing number of older Canadians who are calorie and health conscious.

Beginning in 1985, the federal sales tax was extended to most confectionery goods. However, at that time, competing snack foods were not subject to this tax. This situation probably contributed to declining demand and a consumer shift to alternative snack products such as granola bars or potato chips. In the spring of 1987, the tax was extended to all snack foods.

Although no published data are available on capacity utilization, it is estimated that the industry as a whole operates at about 65 percent of full production capacity.

The total number of confectionery establishments has increased marginally from 110 in 1982 to 113 in 1986, chiefly due to the entry of small businesses. Competitive pressures (especially in the chocolate sub-sector) have led to the closure of a number of large plants and to several mergers which have resulted in consolidation of production facilities and brands. Employment has followed a similar long-term declining trend — dropping from a 1982 total of 9138 to 8908 in 1986.

In 1987, Hershey acquired the confectionery business of Nabisco Brands (Lowney, Moirs), which included the Canadian rights for brands such as Oh Henry!, Lifesavers and Planters Peanuts. In the same year, William Neilson Limited acquired the former Canadian Cadbury Schweppes product lines and, in 1988, Nestle Canada acquired Rowntree MacIntosh (which includes the Laura Secord Division). Together with Effem Canada Ltd. (Mars bars), these four firms dominate the industry. Chiefly chocolate producers, Hershey also has a significant share of the domestic licorice and hard candy market, while William Neilson Limited has diversified into ice cream, milk and other dairy products.

Chewing gum consumption dropped in volume by more than 20 percent between 1982 and 1986. The decrease relates to the declining portion of young people. However, new brands, new long-lasting flavours and the growth in sugarless gum have all helped to compensate for the decline in mature products.

2. Strengths and Weaknesses

Structural Factors

Firms in the confectionery industry compete on the basis of brand-name products, specialty products, product quality and cost of production.

The primary ingredients used are sugar, nuts, cocoa and dairy products. Sugar represents about 10 percent of the cost of raw materials and, for this ingredient, Canadian producers normally have an advantage over many international competitors. The United States maintains a high domestic price for sugar, while Canadian processors derive a significant benefit from their ability to purchase sugar at (normally) lower world prices.

Higher Canadian dairy prices are an offsetting disadvantage for milk chocolate producers. Competitive dairy prices can, however, be negotiated with the Canadian Dairy Commission for external trade. Dairy ingredients also account for about 10 percent of the total cost of raw materials.

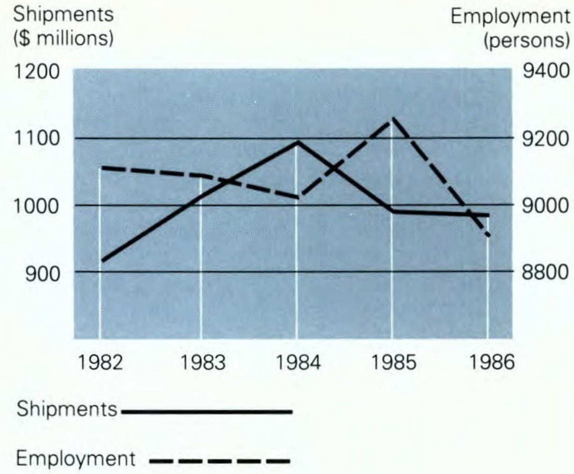
Production costs are sensitive to increases in world sugar, nut and cocoa prices. The costs of these traded commodities are often volatile. When costs increase significantly, processors have no easy way to pass them along to consumers while retaining their traditional share of the snack food market.

Confectionery can lose its relative share of the snack food business if product prices rise. During the disruptive periods of volatile ingredient costs, there is increased intra-industry competition. Manufacturers are reluctant to raise their prices but often attempt to reformat products to compensate. However, this practice also disrupts the normal production process and depresses profits. In addition, Canadian MNE firms, which make some products for export to their U.S. parent companies, are less competitive when sugar prices rise. In general, exports to the United States are also sensitive to exchange rates and quickly become less competitive as the Canadian dollar rises.

Product promotion plays a substantial role in establishing brand-name presence in the various regional markets of Canada. Confectionery products are characterized by discretionary and high-impulse purchases. Because there is a wide selection of confectionery brands and other snack foods for consumers to choose from, promotional expenditures are considerable.

Promotion occurs both within the trade and through the media directly to consumers. The Confectionery Manufacturers' Association estimates that 1985 advertising costs were approximately $33 million, or slightly more than three percent of sales. Generally, much more money is required to promote confectionery brands than other food products. The cost of national advertising is often prohibitive for smaller processors — a fact that restricts entry in some product lines.

A number of established specialty manufacturers — typically medium-sized and independent firms — have maintained their traditional regional markets based on local allegiance or seasonal products rather than strong brand promotion. To suit domestic taste preferences, Canadian products are sometimes formulated differently from American products. In general, Canadians prefer sweet, creamy chocolate whereas U.S. consumers prefer less sweet, dark chocolate. This preference, and the industry's ability to service the market, provides it with additional protection and supports small regional producers who cater to local tastes.



Total Shipments and Employment

Trade-related Factors

Canadian tariff rates on imported products are 13.1 percent ad valorem for confectionery which contains chocolate, and 15.5 percent ad valorem for sugar candy and other confectionery items. By comparison, tariffs in Canada's major export market, the United States, are five percent ad valorem on chocolate confectionery and seven percent ad valorem for all other confectionery. In the European Community (E.C.), tariffs on imports range from 12 to 27 percent ad valorem, but there is also an additional levy on all sugar-containing products, which varies according to the content of sugar. This translates into effective tariff protection ranging from 30 to 60 percent ad valorem on most confectionery products.

The United States currently imposes quotas on the import of some sugar-containing products but, to date, confectionery goods have not been affected. These restrictions can be applied due to a waiver from normal trade rules which was granted to certain American agricultural products when the United States joined the General Agreement on Tariffs and Trade (GATT). In the past, the restrictions have only been applied to select products containing sugar, and must be justified by determining that such products undermine the U.S. sugar policy.

The Canada-U.S. Free Trade Agreement (FTA) will phase out tariffs on all confectionery goods in equal steps over 10 years. The FTA also stipulates that Canada will be exempt from any import quotas the United States may apply to products with 10 percent, or less, sugar by weight. Most confectionery products would, however, fall in the category of "greater than 10 percent sugar", which was not negotiated. For this reason, potential still exists for restricted access for Canadian confectionery products, if the United States can demonstrate successfully that they undermine its sugar policy.

Technological Factors

The large and mid-sized firms in the Canadian confectionery industry are generally capital intensive, technically modern and efficient. Entry to the industry can, however, be gained by firms with low levels of technical sophistication. The smaller firms often use less modern equipment and run operations that are labour intensive.

Technology development in confectionery is low compared to other industries and is usually done by outside machinery manufacturers. Most firms are well informed of new international process developments, normally available "off-the-shelf". Proprietary process improvements, new product formulations and ingredient improvements occur regularly, especially within larger MNEs which often share these developments with their Canadian subsidiaries.

3. Evolving Environment

In recent years, product lines and trade names have been consolidated through mergers and acquisitions. This has led to greater concentration of market shares and resulted in the increased plant efficiencies necessary to compete internationally.

The same phenomenon is taking place in the United States. However, brand-name acquisitions made by U.S. parent firms do not necessarily correspond to those made by their Canadian subsidiaries. For example, Hershey (U.S.) recently acquired Cadbury Schweppes (U.S.) but, in Canada, William Neilson Limited acquired the Cadbury Schweppes lines. Nestle (U.S.) owns the Oh Henry! brand, but Hershey Canada Inc. acquired the Canadian rights to Oh Henry! when it purchased the Nabisco confectionery businesses. The MNEs' acquisition of brand labels appears to be a way to prevent the erosion of domestic market shares rather than strong international company allegiances or trade goals.

Demand for many industry products has suffered due to changing demographic influences and slow population growth. Recent products developed to meet consumer concerns about dental caries or high-calorie foods include a variety of sugar-free gum products. Sugarless gums are now estimated to represent about 40 percent of the total chewing gum market — as compared to 20 percent in 1984. As the cost of artificial sweeteners (such as aspertame) continues to decrease and, as regulations governing their use are eased, more low-calorie confectionery products are expected to be developed for this growing market.

The growth of retail gourmet candy shops indicates an emerging specialty market which recognizes that the consumer is willing to buy quality confectionery products at premium prices. The present volume of commerce is small but expected to increase. Most retail shops base their merchandise on imported goods, but some domestic producers are starting to supply the gourmet specialty market, specifically with quality chocolate products.

The industry has been, and will continue to be, hard pressed to compete with the quality products coming from Europe. Imports of premium chocolates, as well as hard candies, have taken an increasing share of the Canadian market over the last decade. It is evident that quality and the necessary technology associated with the production of these higher-priced products are more advanced in Europe. The demand for these premium goods in Canada does not yet warrant head-to-head competition, but some firms will be gradually forced to improve quality in the face of European competition.

The last two years have seen a small but growing volume of exports to Japan in both hard and soft candy, based on a strong demand for western-style consumer products. The U.S. market also offers potential for specialty products, especially in large border markets. A tariff-free environment and normally lower sugar costs should encourage additional exports to the U.S. market, but will also require Canadian firms to reduce costs and be more efficient.

The FTA includes an exemption for Canada from any future quotas the United States may impose on sugar-containing products with 10 percent (or less) sugar by weight. There is, however, a risk that some Canadian exports of sugar-containing products could still come under quota.

4. Competitiveness Assessment

A series of rationalizations has created more efficient operations and many large and mid-sized firms now use modern equipment. However, the industry must increase productivity to compete with growing imports, and increase its export sales to compensate for a declining domestic market.

The Canadian industry currently operates behind a high tariff wall. Under the FTA, chocolate manufacturers will be under some pressure because they pay higher dairy prices than U.S. competitors and will lose their tariff protection. Canadian confectionery manufacturers may face some scale disadvantages compared to American firms but, at the same time, will normally have a cost advantage in sugar. Taste differences, specialized products and differing brands or brand ownership may also help separate the two markets. On balance, the FTA should have a relatively limited impact on the industry.

For further information concerning the subject matter contained in this profile, contact:

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235 Queen Street
Ottawa, Ontario
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(613) 954-2918

PRINCIPAL STATISTICS SIC(s) COVERED: 1082/1083 (1980)

	1973	1982	1983	1984	1985	1986
Establishments	112	110	110	110	99	113
Employment	10 463	9 138	9 096	9 014	9 265	8 908
Shipments ($ millions)	312	922	1 023	1 095	990	986
Investment ($ millions)	N/A	49.8	52.5	42.5	49.0	58.6

TRADE STATISTICS

	1973	1982	1983	1984	1985	1986	1987
Exports ($ millions)	21	55	54	99	96	130	139
Domestic shipments ($ millions)	291	867	969	996	894	856	N/A
Imports ($ millions)	56	157	171	231	246	264	278
Canadian market ($ millions)	347	1 024	1 140	1 227	1 140	1 120	N/A
Exports as % of shipments	6.7	5.9	5.3	9.0	9.7	13.2	N/A
Imports as % of domestic market	16.1	15.3	15.0	18.8	21.6	23.6	N/A

Source of imports (% of total value)		U.S.	E.C.	Asia	Others
	1982	40	45	—	15
	1983	39	45	—	16
	1984	38	45	—	17
	1985	38	46	4	12
	1986	37	47	3	13
	1987	39	45	4	12

Destination of exports (% of total value)		U.S.	E.C.	Asia	Others
	1982	80	6	—	14
	1983	90	3	—	7
	1984	99	1	—	—
	1985	98	1	1	—
	1986	97	1	1	1
	1987	96	1	1	2

(continued)

REGIONAL DISTRIBUTION — Average over the last 3 years

	Atlantic	Quebec	Ontario	West
Establishments – % of total	6	30	47	17
Employment – % of total	7	18	71	4
Shipments – % of total	5	19	72	4

MAJOR FIRMS

Name	Ownership	Location of Major Plants
Allan Candy Ltd.	Canadian	Hamilton, Ontario
Dare Foods Limited	Canadian	Kitchener, Hamilton Milton, Ontario
Effem Canada Ltd.	American	Surrey, British Columbia Newmarket, Ontario
Ganong Bros. Ltd.	Canadian	St. Stephen, New Brunswick
Hershey Canada Inc.	American	Smiths Falls, Ontario
Kerr Bros. Limited	Canadian	Toronto, Ontario
Rowntree MacIntosh Canada Ltd.	Swiss	Toronto, Ontario
Warner-Lambert Canada Inc.	American	Toronto, Ontario
William Neilson Limited	Canadian	Toronto, Ontario

Note: Statistics Canada data have been used in preparing this profile.

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