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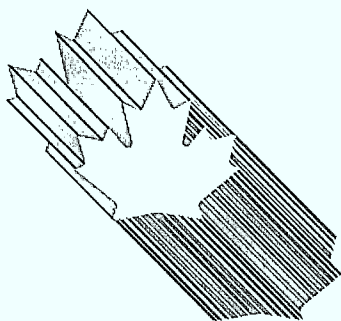


Industry, Science and
Technology Canada

Industrie, Sciences et
Technologie Canada

Bakery Products

Canada



INDUSTRY PROFILE BAKERY PRODUCTS

1988

FOREWORD

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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.

1. Structure and Performance

Structure

The bakery products industry can be divided into two sub-sectors: wholesale bakeries and retail bakeries. Both are engaged in baking bread, rolls (sweet and unsweetened), cakes, pies, pastries and similar perishable products. Wholesale bakeries also include firms which produce frozen, pre-mixed doughs and frozen, pre-formed products.

Retail bakeries produce and sell on the premises, and cater to the demand for freshly baked goods such as crusty rolls, rye breads or pastries. They can produce these either from frozen, pre-mixed dough supplied by wholesalers or from "scratch."

The wholesale bakeries sub-sector is a part of the manufacturing industry, and is the primary focus of this profile. Wholesale bakeries produce volume products, such as white bread, which are typically sold directly or on consignment to grocery stores, chain stores or the food service business. In this industry, manufacturing encompasses captive distribution facilities, which, in most cases, include both trucking and warehousing operations.

The size of Canadian production facilities ranges from small, two-person independent retail bakeries, in-store bakeries and franchise retail chains to several full-range or specialty wholesale plants employing more than 1000 people.

In 1986, there were 479 wholesale bakery establishments, located across Canada, which shipped products valued at \$1.552 billion and employed a total of about 22 000 people. Exports in 1986 totalled \$73 million, almost all directed to nearby major population centres in the United States, while imports amounted to \$42 million. The retail sub-sector, which serves the market for goods baked fresh and sold "over-the-counter," comprises about 1800 firms and accounts for about \$450 million in annual sales. Many of the in-store retail bakeries are considered traffic builders rather than profit centres. Both sub-sectors of this industry primarily serve the domestic market.

Wholesale bakery establishments are located in all regions of the country, their size and number being roughly proportional to the population. The major firms include Weston Bakeries Ltd., Corporate Foods Limited, McGavin Foods Limited, Ben's Limited, Multimarques Inc. and Eastern Bakeries Limited. Some are active in more than one province through branch plants, subsidiaries or affiliates.

Historically, the concentration level of the wholesale bakery products industry has been among the lowest of all of the sub-sectors of the food and beverage industries. The four largest enterprises account for only about 30 percent of industry shipments, and the eight largest for about 47 percent. By contrast, the corresponding figures for "all food and beverage industries" are 50 and 68 percent respectively.

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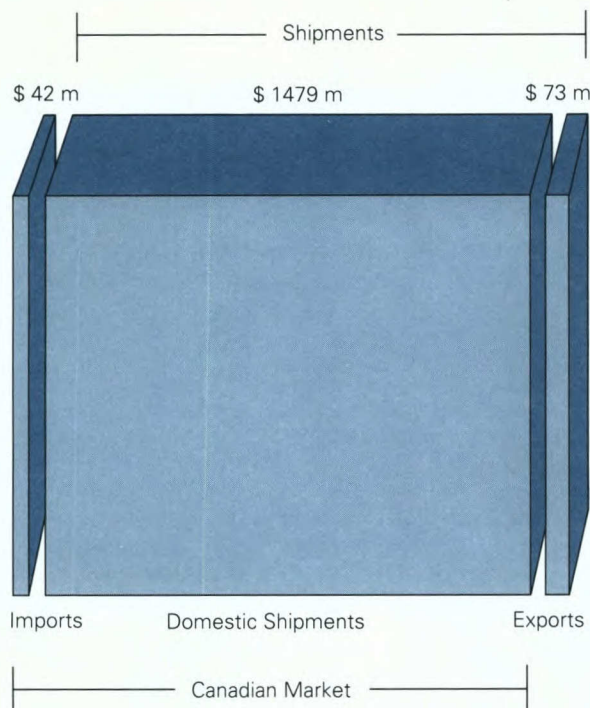
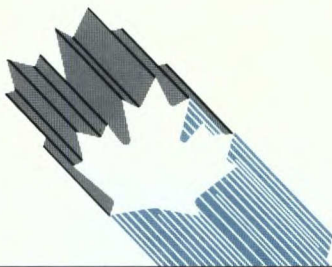
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*Imports, Exports and Domestic Shipments
1986*

Foreign ownership has not had a major influence on the structure of this industry. Because of the need to deliver its perishable products to market quickly, the industry tends to operate small, widely dispersed regional plants. This practice runs counter to the normal business strategies of large, foreign multinational corporations. In addition, the business is relatively easy to enter and there are often periods of excess capacity which contribute to relatively low profits.

Performance

Between 1981 and 1986, the value of bakery product shipments, adjusted for inflation, declined by about four percent. The number of establishments has continued to fall proportionately, and industry employment has dropped. These trends reflect the declining demand for the key product of the wholesale sub-sector, white bread, which accounts for about 50 percent of the value of industry shipments.

Recent studies reveal that average industry profits tend to be low in comparison with those of other food manufacturing industries. Indeed, return on investment has decreased from a relatively low median value of 4.3 percent in 1980 to a level of 0.9 percent in 1985.

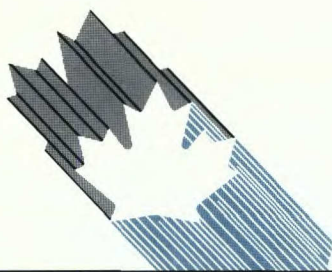
The industry is estimated to be operating at about 70 percent of full production capacity. This low rate has persisted over the past eight years, and, again, is largely due to the declining demand for wholesale bakery products. Annual per capita consumption figures indicate a drop from a high of 42 kilograms (93 pounds) in 1961 to a recent level of about 28 kilograms (63 pounds). However, in terms of the total disposition of bakery goods, this statistic does not include data from the emerging in-store, franchise or restaurant bakeries.

Consumer preferences have turned from standard baked goods, such as the white bread produced by wholesale bakeries, to multi-grain dark breads, pumpernickel and other such nutritional and "up-scale" products introduced by in-store or franchise bakeries and sold fresh over the counter. At the same time, a number of other influences, such as a lower number of school-age children, an aging population, as well as different consumer tastes, have also contributed to the decline in the consumption of white bread.

Persistent excess capacity in the Canadian industry has resulted in considerable attrition of businesses over the last decade. It has also been the driving force behind several major corporate consolidations. Between 1980 and 1986, the number of wholesale baking establishments fell from 631 to 479. In many large metropolitan areas, restructuring has resulted in large-scale plants capable of lowering unit costs through long production runs of a single product. As a result, corporate concentration in the wholesale industry has been slowly increasing.

At the same time, the cost advantages achieved through production efficiencies have enabled these large firms to increase the pricing pressure on their smaller wholesale rivals. However, there are inherent limits to the benefits of production line consolidation in Canada, as increased distribution costs associated with centralized operations offset the gains of scale economies. On average, distribution costs are estimated to represent a significant 40 percent of the total selling price of bakery products.

An increase in the number of successful franchise and in-store operations on the retail side has provided additional competition for wholesale bakeries. Not only have they lost market share, but their large bulk deliveries to chain stores have declined. This attrition of their market has also contributed to the rise in distribution costs in relation to sales.

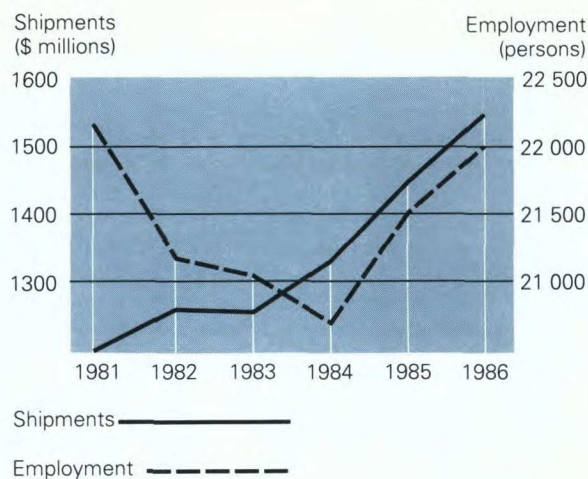


International trade does not play a large role in this industry although, over the last 12 years, exports of bakery products have been consistently greater than imports, with an average annual surplus of \$19 million. More recently, between 1980 and 1986, the value of Canadian exports has increased from \$38 million to \$73 million. This rise in exports can be attributed largely to excess capacity in several large firms which have the capability to supply newly developed frozen products to a large U.S. market. About 50 percent of Canadian exports is in these products, which are less perishable than traditional baked goods and therefore more suited to long-distance shipping. This trade also includes some bread and finished specialty products. In the medium term, frozen goods are expected to continue to make up a large part of export trade.

Imports, chiefly from the United States (72 percent) and the European Community (E.C.) (21 percent) are low, and capture only about 2.7 percent of the Canadian market. Most U.S. imports are standard items such as bread, rolls or pies. Products from the E.C. are usually high-cost, specialty baked goods catering to ethnic tastes.

On average, flour accounts for about 40 percent of the cost of raw materials. Between 1985 and mid-1988, Canadian domestic wheat prices were significantly higher than world prices because the Canadian Wheat Board (CWB), for reasons of public policy, had set different prices for the domestic and export markets. During this period of high domestic wheat prices, however, price concessions were made for exports of finished products using a significant amount of flour. Another consideration was the fact that import penetration of bakery products in most regions of Canada has always been low. For these reasons, the two-price policy is not considered to have had a harmful effect on the overall performance of the industry, although it probably did contribute to competitive problems in some regional markets close to viable U.S. sources of imports.

Nevertheless, the government duly recognized the problem of cost competitiveness in the domestic market for all industrial flour users. As a result, and in view of the Canada-U.S. Free Trade Agreement (FTA), the CWB policy was changed, as of August 1, 1988, to allow sales of wheat for domestic consumption at North American prices. The change enabled firms in border regions, such as Vancouver, where imports have been disrupting the local market, to be more competitive.



Total Shipments and Employment

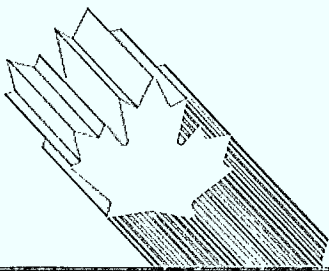
2. Strengths and Weaknesses

Structural Factors

The structure of this industry is influenced by the perishable nature of the product, the regional character of the Canadian market and transportation costs.

Most baked goods are perishable in a matter of days. In addition, these products are often bulky or fragile, and the cost of transporting them to widely dispersed markets is considered high in relation to their value. As a result, the large firms in the Canadian bakery products industry have followed a practice of acquiring a number of small, regional operations, rather than trucking products from centralized plants to surrounding population centres.

These conditions have served to isolate Canadian wholesale bakers from most domestic or international competition. International trade in fresh bakery products is consequently only significant in areas where there are large population centres close to border points. As noted earlier, imports of bread products into British Columbia have been a major concern to the local industry. This penetration is due, in part, to substantially lower U.S. costs for both labour and (until recently) flour. The situation is less critical in eastern Canada, where the difference between U.S. and Canadian labour rates is not as significant. Average wage levels in Canada, although higher in some regions, are about 15 percent lower than those in the United States.

**Trade-related Factors**

Baked goods enter the United States duty-free. The Canadian tariff on pre-formed frozen doughs is 10 percent, while cakes, pies and doughnuts are protected by a rate of 12.5 percent, and bread in retail packages is tariff-free. There are relatively few non-tariff barriers (NTBs) in the bakery products trade.

Under the FTA, all tariffs on bakery products will be eliminated over a period of 10 years. For reasons of perishability and the high cost of transportation, the FTA is not expected to have a large impact on this industry.

Technological Factors

Although the Canadian industry includes several large, modern plants, it is generally characterized by smaller operations with antiquated plant equipment. The current emphasis is on increasing the productive life and efficiency of existing operations rather than replacing them. Despite these limitations, the speed of measuring, mixing and baking has generally increased over time, as has the efficiency of packaging, storing and distribution.

Manufacturers have developed innovative formulations for new frozen products as well as such baking ingredients as "no-time dough," which drastically lowers the waiting period for dough to rise.

The machinery used by the industry is usually available "off-the-shelf." In general, new capital investment has been held back because of low profitability. However, several of the large-scale specialty plants use very modern processing equipment. No major changes are expected in the industry as long as excess capacity persists.

Other Factors

Much of the hard wheat used in baking is produced in western Canada. By legislation, the CWB is the sole marketing agent for western Canadian wheat, with the exception of small quantities grown outside of the CWB area in British Columbia. As noted previously, the two-price system for Canadian wheat was eliminated as of August 1, 1988. However, imports of primary flour or processed flour products shipped in bulk packages will continue to be under import control. Processed products with a high flour content have never been subject to import controls if their packaged contents weigh less than 2.5 kg. Under the FTA, once subsidies to producers are equalized between Canada and the United States, all restrictions on trade will be eliminated.

3. Evolving Environment

The major problems facing wholesale bakeries are the overall decline in market demand and the shift in consumption patterns. These changes are chiefly the result of slow population growth and unsettled consumer demands. Many of these markets are based on new ethnic tastes or nutritional concerns. Of particular importance for the baking industry is the increased awareness among consumers of the need for more fibre in foods.

Consumers have also shown a significant preference for goods which are baked and sold fresh "over-the-counter." Wholesale bakeries have contributed to the growth of retail stores by producing easy-to-use, pre-formed frozen doughs, along with dry and frozen mixes. In-store operations, sometimes referred to as "bake-offs," are often no more than store space for ovens, which bake convenient frozen or pre-formed products.

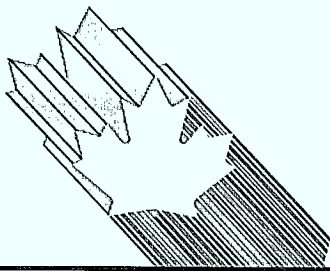
Wholesale operations are also gradually moving some of their production out of white bread and into specialty products such as full-grain dark breads, pita breads, pizza shells, muffins and croissants. However, these specialized market segments are often very small and not capable of generating the benefits of mass production.

Under the FTA, all tariffs on baked goods will be eliminated over a 10-year phase-out period. The loss of tariff protection is unlikely to cause significant disruption in the Canadian market, as trade is minimal because of product perishability and high transportation costs. White bread, the principal product of this industry, is already duty-free. Also, the CWB has enhanced the competitiveness of the Canadian industry by eliminating its two-price wheat (flour) policy.

4. Competitiveness Assessment

The industry continues to be in a position of substantial overcapacity. This situation suppresses profits and makes it difficult for firms to invest in new plants and modern equipment, thereby limiting the improvement of productivity.

Wholesale operations have gradually moved part of their production into new products, some of which are also used by franchise and in-store bakeries. However, few of the new product categories cater to markets large enough for wholesalers to benefit from long production runs.



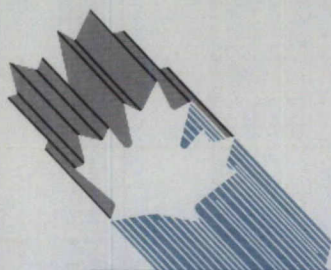
While in-store and franchise bakeries have created a new market for wholesale bakeries, competition from them has also eroded demand for many traditional wholesale products. Until the transition is complete, these and other dislocations in the markets will put pressure on large firms to make adjustments. More mergers and plant closures are expected.

Prices of raw materials, transportation and labour will remain the major factors influencing the competitiveness of this industry, which is largely a matter of inter-firm rivalry. The overall impact of the FTA is likely to be largely neutral.

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

Service Industries and Consumer Goods Branch
Industry, Science and Technology Canada
Attention: Bakery Products
235 Queen Street
Ottawa, Ontario
K1A 0H5

(613) 954-2918



PRINCIPAL STATISTICS

SIC(s) COVERED: 1072* (1980 Basis)

	1981	1982	1983	1984	1985	1986
Establishments	530	555	493	485	473	479
Employment	22 188	21 229	21 061	20 748	21 505	22 000
Shipments (\$ millions)	1 200	1 280	1 275	1 341	1 455	1 552

TRADE STATISTICS

	1981	1982	1983	1984	1985	1986
Exports (\$ millions)	39	48	52	57	63	73
Domestic shipments (\$ millions)	1 161	1 232	1 223	1 284	1 392	1 479
Imports (\$ millions)	25	28	34	35	39	42
Canadian market (\$ millions)	1 186	1 260	1 257	1 319	1 431	1 521
Exports as % of shipments	3.3	3.8	4.1	4.3	4.3	4.7
Imports as % of domestic market	2.1	2.2	2.7	2.7	2.7	2.8
Source of imports (% of total value)			U.S.	E.C.	Asia	Others
	1981	76	18	1	5	
	1982	72	20	1	7	
	1983	68	29	1	2	
	1984	77	17	1	5	
	1985	73	21	1	5	
	1986	72	21	1	6	
Destination of exports (% of total value)			U.S.	E.C.	Asia	Others
	1981	96	1.1	—	3.0	
	1982	96	0.8	—	3.0	
	1983	97	1.1	—	1.9	
	1984	96	1.0	—	3.0	
	1985	97	0.6	0.2	2.2	
	1986	97	1.0	—	2.0	

(continued)

**REGIONAL DISTRIBUTION — Average over the last 3 years**

	Atlantic	Quebec	Ontario	West
Establishments — % of total	5.9	29.5	31.6	33
Employment — % of total	7.2	34.2	36.6	22
Shipments — % of total	6.9	35.0	35.1	23

MAJOR FIRMS

Name	Ownership	Location of Head Offices
Ben's Limited	Canadian	Halifax, Nova Scotia
Corporate Foods Limited	British	Etobicoke, Ontario
Eastern Bakeries Limited	Canadian	Saint John, New Brunswick
McGavin Foods Limited	Canadian	Vancouver, British Columbia
Multimarques Inc.	Canadian	Montréal, Quebec
Weston Bakeries Ltd.	Canadian	Toronto, Ontario

* Data in fact sheet are for wholesale bakeries only.

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

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