Working for the UK
our contribution to the economy

A report prepared by

University of Reading

Food and Drink Federation FDF
Foreword

As the voice of the country’s leading manufacturing sector, one of the Food and Drink Federation’s top priorities is helping our members maximise their competitiveness, primarily by ensuring they are operating in an appropriately regulated market.

That means we spend a lot of time ensuring key stakeholders understand how this industry actually works as well as reminding them that a successful food and drink manufacturing sector is absolutely vital for the UK economy. That’s part of the reason why we commissioned this study, which was carried out by Professor Bruce Traill from the University of Reading.

It confirms some important facts about our industry and also highlights our importance to the country’s economy – at both a national and regional level.

But this study does more than just present facts and figures. As part of their research, Professor Traill and his team also talked with a cross-section of FDF’s membership – manufacturers of all sizes in key product categories – to get their views on the opportunities for the industry and a sense of what they think will act as a brake on that future growth.

The results of this survey of members, and the conclusions drawn by Professor Traill from his general analysis of our industry, will feed into FDF’s work, helping us focus on the things that matter most to our members as we continue to put across the industry’s perspective on the important issues of the day and seek to work collaboratively with the Government, and others, to address them.

We are also launching new initiatives that will ensure we are better placed to tackle some of the points raised by the study. Our SME Forum, for instance, will give a stronger voice to the small and medium-sized businesses that are so important to the food and drink manufacturing industry.

Of course, while important, our economic performance is just part of the story. Food and drink manufacturers are committed to making a positive contribution to the debates about how we improve the health of the nation and, increasingly, the wellbeing of the planet. We have always said that industry should be seen as a willing partner by those looking to find solutions to these very complex issues. And if our industry continues to thrive, we will be in the best possible position to deliver on that promise.

Iain Ferguson CBE
President, FDF
Chief Executive, Tate & Lyle
Trends and outlook

Consumer expenditure on food continues to grow at a little under 2% per annum as people have traded up to more premium and convenience products (including meals outside the home). These trends are expected to continue, but price continues to play an important role in consumer food choices and it is likely that the discount sector will also grow, both through discount supermarkets and ‘value’ own-label offerings among the main retail players. Brands ‘stuck in the middle’ will be squeezed by these trends.

Among premium offerings, health attributes have been increasingly important in new product development and this trend is expected to strengthen, both through increases in functional foods and reformulations to improve health profiles. Products with perceived environmental attributes, such as a low carbon footprint, are expected to become important in the next few years. These suggest the technological content of products and processes will increase over the coming years. However provenance (natural, organic, traceable, geographic origin) will also continue to grow in importance.

Concentration of the industry will continue under pressure from powerful retailers and from foreign competition, but there will be plenty of growth opportunities for SMEs as well as large firms.

SWOT analysis

Much of the UK food industry is sophisticated in terms of marketing, technology and logistics. And it has a strong ability to innovate to take advantage of emerging consumer trends, though there are still too many firms with low productivity. Natural selection will reduce these numbers over time.

Government introducing hurried and non evidence-based regulation designed to satisfy public opinion is seen by industry executives as being a big threat to future competitiveness. Other threats include retailer power increasing still further, growing competition from abroad, rising raw material costs and non-uniform enforcement of regulation across the EU.
Our observations

Concerns about food safety and unhealthy eating patterns in the UK have combined to negatively impact the industry’s image. Indeed, the executives we interviewed fear that the industry’s reputation is lower among UK citizens than it is among those living in other EU countries and the US. Industry and Government must both bear some of the responsibility for this and must work better together to improve the image of this important manufacturing industry, recognising that they have many common goals such as economic growth and stability.

It’s clear from our research and interviews that many executives feel that Government could help by consulting the industry more fully before enacting legislation and that it should also act in a measured manner, introducing regulation that is evidence-based.

There is also a perception that the UK Government should continue pressing other EU Member States and the European Commission to ensure that EU regulation is implemented and enforced on an equal basis across the region. At the same time, the UK Government and industry must continue working with other Member States to promote a more proportionate EU regulatory environment for Europe.

Efforts to support trade liberalisation through the Doha Round and the continuing reform of the Common Agricultural Policy are also important for this industry.

A shortage of skilled labour is a problem felt by many sectors, but is arguably even more acute for food and drink manufacturers given the negative publicity that has surrounded the industry in recent years. Government efforts to raise the skills base would clearly be welcomed.

Parts of the industry also face shortages of unskilled labour in some areas of the UK.

Industry recognises that many consumer concerns are valid and must continue to respond to them quickly to build mutual trust (for instance, through its ongoing product reformulation programmes). Such an approach will always be preferable to a defensive strategy. But the food and drink sector also needs to communicate its own position better, both to Government and to the public, whilst recognising that the interests of politicians, consumers and industry cannot always coincide. In all of this, the Food and Drink Federation must play an increasingly central role.
Introduction

The aim of this report is to investigate the importance of the food manufacturing industry to the overall UK economy, notably the manufacturing industries, where relative economic decline in this country has caused some alarm. The needs of the industry to maintain and enhance competitiveness are studied.

A similar exercise has been undertaken by the CIAA (Confederation of the Food and Drink Industries of the European Union) for the European food industry\(^1\). This emphasised the need for increased R&D activities and innovation performance, developing a simpler and more proportionate EU regulatory framework and ensuring sustainable and competitive supplies of agricultural raw materials.

In the present report we study the UK context to determine whether the UK food industry has specific issues and needs. To this end we begin with a review of literature and statistics to assess the importance of the industry and its performance in recent years. As well as the review of data sources and previous reports on the sector, a series of in-depth interviews were undertaken with senior food industry executives covering a range of company sizes and types.

From all this research, trends and drivers of change in the food industry have been identified and a SWOT (Strengths, Weaknesses, Opportunities and Threats) analysis has been developed. Based on this we identify what industry needs to do to exploit its strengths, grasp emerging opportunities, avoid threats and overcome weaknesses. Issues that should be addressed by industry, Government or both are highlighted.

\(^{1}\)CIAA benchmarking report 2006: the competitiveness of the EU food and drink industry, CIAA, Brussels, May 2006; and 2007 update report.
### Factual Background

#### Importance of the industry

**Food and drink industry is the biggest manufacturing sector**

The first thing to note about the food and drink sector is its size. Food and Drink Manufacturing (FDM), with a turnover of almost £74bn and value added of £21.5bn, is the UK’s largest manufacturing sector as shown in Figure 1. Different Government data show that the industry employs between 411,000 and almost 470,000 people. Whichever figure you choose, the message is the same: this sector is a major employer. There’s more good news: whereas from 1998 to 2004 the number of employees in the manufacturing sector as a whole fell by 28%\(^2\), the number of FDM employees fell by only 13%.

**The fastest growing manufacturing sector**

The industry is not only important because it is large; at a time when UK manufacturing as a whole is struggling, FDM is growing. Value added has expanded by 19% since 1998 whereas, over the same period, value added growth for manufacturing as a whole was only 1%.

**A stabilising element to the economy**

Not only is the industry expanding but, given the inelastic nature of food demand, it is little affected by the income variations of the business cycle and so acts as a stabilising force to manufacturing output and employment.

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#### A vital outlet for agriculture

Food and drink manufacturing is central to the UK food chain. As shown in Figure 2, exports of unprocessed primary products, at £0.7bn, are very low implying that virtually all of agriculture’s £14.8bn output and its 534,000 workforce depend on the UK market, of which a healthy processing sector is critical. This is of crucial importance given the precarious state of UK agriculture in recent years.

In addition, some 1.2m jobs in other supply industries depend on a successful UK food manufacturing sector\(^3\). Although one might argue that unprocessed agricultural exports would expand in the absence of UK-based processing, agriculture as a whole would contract substantially.

The extent to which UK food retailers and caterers, who together employ 2.5m people, depend on UK based food manufacturing is more debatable. It could be argued that they could source their supplies globally, but for some products the cost would be substantial; environmental consequences would also be harmful and there is a growing interest in local food that obviously cannot be sourced abroad. Thus we conclude that a competitive UK food manufacturing sector is also important to downstream elements of the food chain.

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\(^2\)ONS ABI 2004

\(^3\)Note that the food manufacturing industry includes the supply of own-label produce for retailers.
Figure 2: The UK food chain

The United Kingdom Food Chain

Exports (a)
£9.9 bn of which
Unprocessed £3.6bn
Highly processed £5.6bn

Caterers (restaurants, cafes, etc)
Gross value added £20.6bn
1,373,000 jobs
Enterprises 114,945
Outlets 262,982

Consumers in the United Kingdom
60 million people

Household expenditure
on food and drink £79bn

Grocery retailers
Gross value added £19.6bn
1,157,000 jobs
Enterprises 55,540
Stores 102,511

Exports (a)
£9.9 bn of which
Unprocessed £3.6bn
Highly processed £5.6bn

Consumers’ expenditure
£9.9bn of which
Unprocessed £3.6bn

Total consumers’ expenditure (b)
on food, drink and catering services £156bn

Food and drink wholesalers
Gross value added £7.3bn
196,000 jobs
Enterprises 14,096

Food and drink manufacturing
Includes everything from primary processing (milling, malting, slaughtering) to complex prepared food. Many products will go through several stages.
Gross value added £21bn
411,000 jobs
Enterprises 6,657
Manufacturing sites/factories 8,905

Agricultural wholesalers
Gross value added £764m
21,000 jobs
Enterprises 3,060

Agricultural supply industry (animal feed manufacturing, agricultural machinery, fertilisers and pesticides)
Gross value added £1.1bn
26,000 jobs
Enterprises 1,600

Distribution
Involved at all part of the chain

Food and drink supply industry (Food processing machinery)
Gross value added £19.6bn
1,157,000 jobs
Enterprises 55,540
Stores 102,511

Farmers and primary producers
Gross value added £5.6bn
534,000 jobs
Farm holdings 311,100
CAP direct subsidies (less levies) £0.08bn
Agricultural land area 18.7 million hectares

Imports (a)
£23.5bn of which
Unprocessed £4.7bn
Lightly processed £10.8bn
Highly processed £8.0bn

Fisheries industry
Gross value added £535m
12,000 jobs
Enterprises 3,847
Fleet size - 6,700 vessels

United Kingdom
All food 58%
Indigenous 72%

Source: Agriculture in the UK, 2006, Defra.

(a) Overseas Trade data are provisional for the full year 2006 from HM Revenue and Customs.
(b) Consumers’ expenditure, properly known as household final consumption expenditure, is a provisional estimate by Defra for 2006 calculated at current prices.
(c) Gross value added figures are provisional data from the Office for National Statistics for 2005 calculated at basic prices (market prices less taxes plus subsidies).
(d) Employee data are for Q3 2006 from the Office for National Statistics.
(e) GVA for food manufacturing does not include farm animal feed, which is included in agricultural supply industry.
An important regional contributor
The food industry is a particularly important contributor to the economies of Northern Ireland and Scotland where it represents respectively 34% and 23% of their manufacturing gross value added and 21% of their manufacturing workforce – as well as to the East Midlands and Yorkshire and the Humber (see Figures 3 and 4). It is proportionately less important in the wealthier London and South East but is in the top 3 manufacturing sectors in terms of GVA in all of the regions except for the South East (where it’s 4th).
It is the most important manufacturing sector in Scotland, the East Midlands, Yorkshire and the Humber, the East of England, the South West, Northern Ireland and Wales.

The most important regions for employment in the industry are the North West (59,900 employees), Yorkshire and the Humber (56,500), the East Midlands (53,100), Scotland (48,700) and the East of England (39,200). Together these regions account for 60% of food and drink GVA and employment in the UK.

Performance of the industry
Productivity – a mixed picture
The most common productivity indicator is labour productivity. Total Factor Productivity (TFP), which measures output in relation to use of all the major inputs within the production process including capital, labour and intermediate purchases, is a better measure offering a more comprehensive picture of productivity, but data are not as widely available.

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4 As well, of course, as supporting jobs in farming and the supply industries.
5 Regional ONS data include tobacco which accounts for a little over 5% of total GVA and 1% of total employment at the national level
6 Productivity is also a good indicator of competitiveness: “Competitiveness at industry level is taken to be synonymous with the broad economic performance of the companies comprising that industry. All in all, therefore, competitiveness should be viewed as being about economic efficiency or productivity”, Development of Competitiveness Indicators for the Food Chain industries, Defra, 2002.
Figure 5 shows that the US has significantly higher labour and total productivity than France, Germany and the UK, which all have similar performances. TFP in the US was 130% of the UK level and labour productivity was 136% of the UK level. This means that a given bundle of inputs in the US would produce 30% more than that same bundle in the UK.

However, within the UK, labour productivity (the only comparable data available) in food and drink manufacturing is some 7% higher than for manufacturing as a whole, as shown in Figure 6, and almost 30% higher than for the economy as a whole.

Food industry productivity growth in the UK also compares favourably with the rest of manufacturing and the economy as a whole. Over the period 1998-2003 food manufacturing had a TFP growth rate of 0.68% pa, which was above the whole economy average of 0.57%. Labour productivity growth averaged only 0.2% per annum during 1995-2001, though this represents some closing of the gap with America where labour productivity contracted at an annual rate of 6%.
Research and development – generally good

R&D is one of the main engines of innovation, productivity growth and structural change. Figure 7 shows that, in terms of business expenditure on R&D (BERD) relative to turnover (often called R&D intensity), the UK performs better than the EU average, slightly worse than the US and much worse than Japan. Figure 8 shows that R&D intensity grew sharply in the UK in the 5 years to 2001.

It has subsequently declined, though this decline is common to the UK economy as a whole where R&D intensity has fallen from 1.92 to 1.76 in the 10 years to 2005*. Although data are not available, it is widely accepted that large firms have a higher R&D intensity than small and medium enterprises (except in some specialised areas).

Figure 7: Main international competitor comparison, R&D as % of food and drink industry output, 2003

Figure 8: R&D as % of food and drink industry output, 1995 – 2004


Source: ONS Business Monitor, 2004
Food manufacturing has been highly profitable

Return on Capital Employed (ROCE) averaged a healthy 29.7% for branded food manufacturers and 17.6% for own-label companies in 2006 (see Figure 9). This follows almost 10 years of profit growth (Figure 10) by the end of which the profit performance is reported to be considerably higher than for manufacturing generally.

Figure 9 also shows that large branded firms, with a ROCE of almost 35%, perform better than large and small own-label firms and smaller branded firms, all of which record a similar ROCE of around half the level of the large branded companies.

Globalisation

In 2005 the value of UK food, feed and drink exports was £9.9bn and the value of imports was £23bn. Figure 11 shows that drinks are the largest export category (£3.5bn) followed by cereals and fish (£1.2bn and £0.9bn respectively). The groups with the largest import values were fruit and vegetables (£5.6bn), drink (£3.7bn) and meat (£3.7bn).

Between 1996 and 2005, UK exports of highly processed food and drink fell by 14% in value terms, lightly processed food and drink fell by 20% and unprocessed foods fell by 45%, though the poor performance of the latter two is partly a result of meat.

Figure 9: Return on Capital Employed, 2006 (%)

Figure 10: Long run profit margin and ROCE (%)

Source: The OC&C/Grocer 150 Index, 2007

Source: The OC&C/Grocer Index 150, 2007

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9The OC&C Grocer 150 Index, 2007.
10Defra, UK Food and Drink Manufacturing: an economic analysis, 2006.
11Alcoholic, natural and artificial mineral waters, aerated, sweetened or otherwise.
12Exports and imports of food, feed and drink are of little importance as contributors to the UK Balance of Payments. Exports of food and drink are 1% of total credits and imports 2% of total debits. Rising incomes at home and the growth of manufacturing capacity across the globe have led to rapid growth in imports of manufactured goods and the percentage contribution of food and drink to total imports has fallen sharply.
export bans associated with BSE and foot and mouth disease. The last four years have shown export growth and, according to Food From Britain, exports grew by 5.8% in 2006\(^7\). For the same period UK imports of highly processed foods and drink increased by 28%, lightly processed foods and drink fell by 0.3% and unprocessed food and drink increased by 0.1%.

Figure 12 shows food exports as a share of world exports for a number of important competitor countries between 2000 and 2005. The measure is recognised as a relevant indicator of international competitiveness. The UK share has fallen slightly (from 2.5% to 2.1%), but not as fast as traditional agricultural superpowers such as the US. Emerging agricultural superpowers like Brazil have increased their share (2.9% to 5%). The overall picture is slightly confused, but suggests a world in which trade in more highly processed food products is growing fastest but where developing and middle income countries are displacing the developed world as the major suppliers to world markets. In this process the US has been the biggest developed country loser (reflecting its traditional focus on the export of bulk commodities) while, against the trend, the EU as a whole has held steady (reflecting the higher degree of value added products in its exports).

\(^7\)Food From Britain Press Release, 20 April 2007.
Foreign Investment fluctuates widely

Figures 13 and 14 show foreign investment flows from and to the UK (net of profit returns). Investment abroad by UK FDM companies over the last 10 years was £34.6bn, with the US being the biggest destination (£21.9bn), followed by France (£3.2bn)\(^{14}\). In recent years FDM outflows have been greater than outflows from the remainder of the manufacturing sector, an indication of the competitiveness of British food companies relative to manufacturing as a whole; investment abroad is another indicator of international competitiveness. It means that the UK economy benefits from both profit returns and payments to other UK based factors of production that support the foreign activities, notably skilled employees in management and research and development.

Foreign investment inflows to the UK food sector have been relatively stable compared to other manufacturing. This inward investment has led to significant job creation in the UK\(^ {15}\). The French were the biggest investors (£10bn), followed by the US (£7.4bn) and Belgium (£2.7bn).

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14 Grant Thornton, April 2007.
Forces for Change

The data presented and discussed above have shown the food industry to be a pillar of strength and stability in the British manufacturing sector, growing steadily while much else is in decline, employing a substantial share of the workforce, increasing productivity and resisting cyclical movements in the economy. It also provides a vital outlet for UK agricultural produce.

But over an extended period of time the industry has changed dramatically, restructuring and introducing new products at an unprecedented pace to meet the demands of an ever-more powerful retail sector intent simultaneously on low prices and product differentiation; only the fittest manufacturers have survived, though fitness in this context is not necessarily synonymous with size.

Over the past two decades the main driving forces for changes in consumer demand have been growth in spending power and changes in demographics and lifestyle which have fuelled the demand for convenience foods, value added products and eating outside the home. As indicated by Box 1 this has meant that overall consumer expenditure on food (and drink) has continued to grow even though calorie intake has stagnated. The various changes imply not only more products and a faster turnover, but that markets have segmented more finely.

Recent trends in the competitive environment facing the food industry include:

- A continuing focus on health (obesity, functional foods, replacement of ‘unhealthy’ ingredients such as trans fats) and the need to respond to new legislation such as the EU Nutrition and Health Claims Regulation, initiatives on advertising to children and nutrition labelling initiatives;
- The continuing need for convenience;
- The continuing need for value;
- The continuing demand for premium and indulgence;
- Fossil fuel and agricultural raw material price increases;

Box 1: Consumer food expenditure trends

Total consumer food and drink expenditure continues to expand as consumers trade up to higher quality. From 2002 to 2006, the amount consumers spent on food consumed outside the home has increased by 11% to £45bn (at 2003 prices) while over the same period food at home grew by 9% to £68bn.

UK Consumer Expenditure on Food and Drink, 2002 - 2006, at constant 2003 prices

![Graph showing consumer food expenditure trends from 2002 to 2006.](image)

Source: Delfra, Agriculture in the UK, 2002 to 2006

Sector Futures: the future of the food and drink sector, European Foundation for the Improvement of Living and Working Conditions, 2004
Emerging Food Industry Responsibilities, Ruth Hussey, A Review of the UK Food Market, 2006
Back to the future: Tomorrow’s food sector will remain vibrant, but will have accommodated new priorities, John Dunn, February 2007.
Increasing consumer concern about various environmental issues, enhancing growth in organic and fair trade products but also leading to concerns about food miles and the broader carbon footprint. Some companies are already responding with proposed labelling initiatives; and

Continuing growth in retailer power. However, these ‘mega-trends’ which have been well documented hide a variety of sub-trends and counter-trends that companies must respond to, as identified for example, in Figure 15 from Improve.

Large manufacturers have made a number of strategic responses to these various developments which involve a mixture of efficiency seeking (cost minimisation) and product differentiation. They include measures to make their plants flexible enough to support a wide product range to serve fragmenting markets; reorganising production into large plants capable of supplying foreign markets; and developing new products based on new technologies.

Medium-large companies are particularly well suited to meeting the growing demands of retailers for own label products. They are able to take advantage of economies of scale in production, can be flexible and rapid in response to retailers’ needs, and are able to avoid the costs of creating and maintaining brands.

Medium to large companies whose success depends on secondary brands have found themselves squeezed between private label and major brands.

Broadly speaking there are four ways in which small companies compete within the food industry: on the basis of cost in cases where small scale production is most efficient (perhaps to supply local markets); on the basis of producing a highly specialised product for a particular niche market, which may be considered insufficiently profitable for larger enterprises; in developing products in new areas of the market (which if successful can be vulnerable to take-over by larger enterprises); and through their ability, sometimes, to respond more quickly and flexibly than larger firms.

Figure 15: Mega trends and counter trends

<table>
<thead>
<tr>
<th>Mega trend</th>
<th>Sub or counter trend</th>
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<tbody>
<tr>
<td>Supermarkets merge to achieve greater economies of scale and more retail space</td>
<td>Consumers support reintroduction of farmers’ markets and e-shopping</td>
</tr>
<tr>
<td>FDM sourcing and final product markets go global</td>
<td>Consumers think local, provenance and want to keep cultural and regional specialties</td>
</tr>
<tr>
<td>Own label products dominate</td>
<td>Biggest brands get bigger and specialty foods become more popular</td>
</tr>
<tr>
<td>Obesity and health issues drive demand for ‘health’ foods</td>
<td>Consumption of ‘junk’ food unaffected</td>
</tr>
<tr>
<td>Convenience foods presented as an answer to increasing numbers of working men and women</td>
<td>Total leisure time available to the population is increasing, particularly amongst the older age cohorts</td>
</tr>
<tr>
<td>Electronic retailing and virtual shopping malls increase</td>
<td>Many consumers want more service and personal touch</td>
</tr>
<tr>
<td>Science provides ways to increase crop yields and feed conversion rates</td>
<td>Environmental constraints and consumer demands pushing towards extensive food production and agriculture, low input farming, no scientific manipulation</td>
</tr>
<tr>
<td>Genetic modification increases possibility of new food products</td>
<td>Consumers increasingly interested in natural and organic, with aversion to GMO</td>
</tr>
<tr>
<td>WTO tries to move towards free trade in Doha Round</td>
<td>Free trade and fair trade are not seen as synonymous</td>
</tr>
</tbody>
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Source: Demand for Skills in the UK Food and Drink Manufacturing Sector: Stage 1 of the Sector Skills Agreement, Demand Drivers, Improve Ltd, July 2006
The next five years

In our interviews with food industry executives we asked about the likely strength of these trends over the next five years and their impact on the food industry. The interviews were semi-structured; concerning future trends, they focused on health, the environment and the general economy and trade, and explored the strength of the drivers, the timing of likely change, the types of firms and sectors that would benefit, threats and constraints facing the UK food industry and how they could be overcome by Government and industry.

Health – a dominant trend

In 2006, 23.3% of new product claims were health related (Box 2). Senior executives we spoke to see this trend continuing and manifesting itself in product reformulation to improve nutritional profiles and continuing development of foods with functional properties. With respect to the latter, the new EU Nutrition and Health Claims Regulation was viewed positively as it provides clear rules for the types of products and claims that can be made.

However, the regulatory situation in the UK with respect to nutrition was felt to be muddled. As regards labelling, the Food Standards Agency (FSA) is encouraging a scheme that many executives feel to be non-scientific (the traffic light system); they feel that further consultation could have avoided the confusing situation where multiple front-of-pack labelling systems are on display.

Many executives also believe that recent restrictions on advertising to children lack a scientific evidence base and could have unintended consequences such as a reduction of competition.

The trend towards ‘healthy products’ offers opportunities for companies of all sizes. Larger companies will rely more on technology to produce functional foods and reformulations (removal of trans fats, lowering of salt, saturated fats and sugar). However companies recognise that taste remains king and reformulation cannot affect the emotional bond between consumers and trusted brands. Smaller companies will find health niches which are less technology dependent. Naturalness, often confused with healthiness by consumers, is one such opportunity.

**Box 2: Types of new product claims in the food industry**

The Grocer (7 July 2007) reports that 23.3% of new products claimed to be ‘healthy’ in 2006, up from 15.5% five years earlier. The other big growth areas are ‘organic’ and ‘environmental’ (the latter from a low base).

**New product claims by category (%)**

![Graph showing new product claims by category for 2001 and 2006.](image)

20See UBS Risk of Reformulations, October 2005.
The environment – emerging trend

It is not yet clear how the trend to environmental consciousness will manifest itself in the market, though Box 2 suggests that there has already been rapid expansion in new products making environmental claims in the past five years, albeit from a small base.

Executives consider that although the environment is not strongly driving food manufacturing at this time, it will begin to affect innovation over the next 5 years, more in terms of packaging and reducing energy usage and waste from production and distribution.

Being at an earlier stage than health, there is time to avoid a confusing regulatory situation, and clarify debates such as whether food miles are a measure of environmental impact (the industry and Defra recognise that they are not, but farmers’ markets and regional food labelling in supermarkets have been significant responses to consumers’ perceptions).

Executives are aware that carbon labelling is a possibility, but want to see a Government-led standard for measuring carbon footprint to avoid consumer confusion.

There is also real concern among most executives that the demand for bio-fuels will force up the price of agricultural raw materials for the food industry, at a time when other factors are having a big impact.

Convenience, premium and price will continue to be important drivers

It is all too easy to think the market will be entirely driven by health and the environment, but the demand for convenience is seemingly inexorable.

As part of the continuing convenience trend, executives expect that eating out will further grow its share of food expenditure and this is an opportunity for manufacturers.

The strength of demand for ‘indulgence’ products should also not be under-rated, with one key attribute being provenance (natural, traceable, geographic indication). It is expected that there will be a continuing trend for consumers to trade up to more premium products, but despite all this, price will continue to be an important driver, as indicated by the data in Box 3.

Box 3: Growth in both the premium and discount sectors

The view of some executives that premium and discount products will both grow while the ‘middle’ is squeezed is supported by these two graphs that show the number of categories containing Tesco Finest products (now the country’s best selling food brand) and Tesco Value products. Both have shown sharp growth since 2000.

Source: TNS Worldpanel 2007
Retailer power is a fact of life

Retailing in the UK is one of the most advanced sectors in the world and more concentrated than in many countries of comparable size – as shown in Box 4, the top three UK retailers now account for two-thirds of grocery sales.

The executives we interviewed expect that retailers will continue to exert pressure on manufacturers’ margins and felt that retailer-induced rationalisation of supply chains would continue to drive structural change in food manufacturing. But they also believe there will be a position in the market for the small niche player supplying a premium product for a local distribution chain alongside the huge multinational which bases its competitiveness on brand identity and product innovation and/or production efficiency and process innovation.

M&A, offshoring, foreign investment, private equity – more of the same

Restructuring is inevitable in a successful and dynamic industry and food is no exception; it has seen its share of mergers, half of them in the last 10 years by foreign companies, and the industry has itself invested heavily abroad. Executives expect globalisation to be a continuing force, driven in part by anticipated global retailer consolidation and in part by faster growth prospects for processed foods in emerging economies. Executives expect offshoring of production will continue, primarily as a way of maximising efficiencies, though bulkier products will always be immune to this trend as transport costs are too high.

Private equity has been active in the sector and some major manufacturers are owned by private equity firms. But this is not perceived as a disturbing development by most of the executives we interviewed and no-one thought it would have a major negative impact on employment. In any case, it is probable that the rising cost of borrowing will slow the growth of private equity.

Box 4: Continuing retailer consolidation

The structure of the UK food retailing industry has changed dramatically over the last 30 years. Shoppers have moved from the high street to out-of-town superstores and a few large companies have become dominant. In 1990 Tesco, Sainsbury and Asda accounted for 28% of the market but by 2007 this had increased to 65%.

Source: Geoffrey Owen, Corporate Strategy in UK Food Retailing, 2003 and NFU Online UK Food Retailers Market Share April 2007, from TNS World Panel/IGD Retail Analysis

21UBS Investment Research, Packaged Foods, December 2006
22The Economist, July 7 2007.
Strengths, Weaknesses, Opportunities and Threats

Based upon the factual data and the literature we developed a draft SWOT for the UK food industry.

We asked food industry executives during the interviews for their views on its appropriateness and for any suggestions on modification. The resulting modified SWOT presented as Figure 16 reflects the majority view of executives. The more pertinent issues are discussed in the following sections.

Figure 16: Strengths, weaknesses, opportunities and threats for the UK food industry

<table>
<thead>
<tr>
<th>Strengths</th>
<th>Weaknesses</th>
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<tbody>
<tr>
<td>High standards of food quality, safety and sustainability</td>
<td>Lack of trust by public</td>
</tr>
<tr>
<td>Strong ability to add value</td>
<td>Limited support from Government</td>
</tr>
<tr>
<td>Logistics (means of transportation and distribution)</td>
<td>Hostility of NGOs and media greater than in other countries</td>
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<tr>
<td>Experience supplying sophisticated UK retailers</td>
<td>Low productivity in parts of the industry</td>
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<tr>
<td>Technological sophistication</td>
<td>Technical skills shortage</td>
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<tr>
<td>Marketing sophistication</td>
<td>Low availability of unskilled labour – especially if supplies from new Member States dry up</td>
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<tr>
<th>Opportunities</th>
<th>Threats</th>
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<tr>
<td>Demand growth for new products (nutritionally healthy, functional foods, environmentally friendly, convenient, premium, ethnic)</td>
<td>Over-regulation and inconsistency across Government</td>
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<td>Growth of catering market</td>
<td>Legislation introduced prematurely (environment)</td>
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<td>Increased segmentation of markets into target groups</td>
<td>Legislation not science-based (food labelling, advertising restrictions)</td>
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<td>Globalisation expanding opportunities abroad</td>
<td>Over-enforcement of EU legislation compared to other Member States</td>
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<td>Increased technology in products, processes and distribution</td>
<td>Rising raw material costs (energy and agricultural prices because of demand in emerging economies and, partly, due to demand for bio-fuels)</td>
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<tr>
<td>• Product related (reformulations, functional foods, carbon footprint)</td>
<td>Increased competition from other parts of the world</td>
</tr>
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<td>• Processes and logistics (automation, packaging, e-logistics)</td>
<td>Increased power of food retailers</td>
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<td>• Consumer relations (e-trade)</td>
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An industry responsive to consumer needs but suffering from a poor reputation

Executives believe strongly that the food and drink industry in the UK has been extremely responsive to consumer demand. In fact, it is the archetypical market-oriented industry – discovering what its customers want and providing it for them. As a result, it has made available to consumers a huge range of convenient, safe and affordable food.

However, various incidents have hit the food chain, starting (in recent history) with salmonella in eggs, BSE and continuing with, among others, foot and mouth disease, Sudan 1 and avian flu. These have undermined the industry’s reputation and research shows the public in the UK do not trust information on food emanating from farmers or processors. Yet, in reality, the UK food safety record is very good.

The executives we interviewed felt that NGOs are more powerful in the UK than elsewhere in Europe, as is the media, and on the health issue this had resulted in food and drink companies taking much of the blame for the obesity ‘epidemic’ – whereas objective evidence suggests that industry’s only ‘crime’ has been to embrace technological change that has lowered manufactured food prices and made food consumption more convenient. The industry sometimes feels it is made a scapegoat by Government, which fails to recognise its positive contributions to the economy. Executives believe this tendency is much more pronounced than in other countries, notably the US, where they perceive industry and Government working more closely as a partnership.

The industry itself accepts some of the blame for this, with many executives recognising that it has not done sufficiently well at communicating complex issues, such as those involving obesity, to the public.

Policy must be consistent and evidence-based

Executives state that the industry has the technological, product development and marketing skills to respond to continuing demands for convenience, food quality upgrading and price competition – as well as embracing newer trends such as functional foods and reformulating products to make them ‘healthier’.

However, they feel the industry needs better regulation and more joined-up thinking from Government and they are concerned that legislation is often introduced with insufficient consultation.

In the health debate, for instance, they believe the promotion of the unproven traffic light front-of-pack nutrition labelling scheme by the Food Standards Agency was premature. When it comes to the environment, executives feel it is important that Government, with industry support, takes sufficient evidence to make science-based decisions on potentially emotive issues such as carbon labelling and packaging. The need for a single standard for the measurement of a product’s carbon footprint is seen as urgent; already, firms are introducing labelling schemes that are perceived by the executives with whom we spoke as contradictory, confusing and meaningless. There is a risk that the multiplication of such schemes will cause further consumer confusion and damage to industry.

Retailer power – a continuing dilemma

Food retailers have become highly concentrated and powerful in the UK, which has allowed them to put pressure on food manufacturers’ margins and reduce the number of their suppliers. These actions have led to the disappearance (usually by acquisition) of large numbers of firms, but they have also enhanced efficiency in food manufacturing which has kept food prices low, fostered a high level of product innovation and supported the UK’s food industry.

23In a 2004 UK survey of consumers into trust in the food chain, manufacturers were trusted less than all but one of the 22 groups asked about (which included retailers, the media, scientists, doctors, food safety organisations, consumer and environmental organisations etc). Only political lobby groups were trusted less. Lobb AE, Trail WR, Mazzocchi M and McCrea D (2006). Trust across Europe: results from a cross-country survey, pp 65-89 in Romano D and Stefani G (eds), A study on the impact of trust and food risk communication on consumer behaviour in the European Union, Firenze University Press, Florence.

24In 2006 the UK made 66 alert notifications to the EU Rapid Alert System for Food and Feed (RASFF) whereas Germany made 163 and Italy 143. France only made 43 notifications. Notifications include imported produce and the number of notifications reflect the efficiency of control systems as well as the safety of food (RASFF Annual Report 2006).

and upgraded quality and safety. Furthermore, the UK manufacturers’ experiences in meeting the demands of one of the world’s most advanced and demanding food retail sectors puts them in good stead on the global stage where the skills they have acquired are in increasing demand.

The majority feeling among those manufacturers with whom we spoke is that competition is satisfactory at present levels, but they would clearly not welcome any further retailer consolidation.

Open and fair competition

Competition from abroad is expected to intensify, but executives believe the industry is well able to succeed and to this end the continuing reform of the CAP and a successful conclusion to the Doha Round trade negotiations are considered important. Although there will be continued pressure from middle income and transition economies (such as Brazil and Poland), global growth also gives opportunities for expansion abroad – and it is anticipated this will more likely take the form of investment overseas than exports.

The UK is felt to enforce EU legislation much more energetically than some other Member States. The answer, according to the executives we interviewed, is not to relax enforcement in the UK, but for the UK Government to press other Member States to apply rules with the same rigour and for the European Commission to ensure they do.

Supporting a technologically sophisticated industry

Michael Porter of the Harvard Business School has identified Advanced Factors of Production as a key element in an industry’s competitiveness. What this mainly amounts to is the provision of an infrastructure of R&D and a suitably trained workforce.

In its report, the CIAA emphasised the importance of R&D, particularly to small and medium firms, and urged the EC to ensure the success of its 7th Framework Programme for R&D as well as related innovation programmes. In the UK, private sector food industry R&D is at a higher level than in other EU Member States and our interviews revealed little enthusiasm for greater UK public sector investment in food R&D.

The executives we interviewed placed much more emphasis on the shortage of skilled workers. This, they fear, is partly because of the food industry’s reputation, which makes it less attractive to the brightest graduates in disciplines such as marketing and finance, and is partly because of a lack of demand by students for training in food science and technology.

This is a perennial and long-standing problem with no easy solutions – as evidenced by many years of industry-academia collaboration to reverse the process. Again, joint industry-Government efforts to improve the reputation of this most significant industry will be important.

The food and drink industry also has a high demand for unskilled labour and has been cushioned from shortages in recent years by the inflow of workers from new EU Member States. This is one reason why large parts of the industry have maintained labour intensive production methods (and why parts of the industry have low levels of labour productivity). Executives consider it unlikely that the supply of such labour will continue in the medium term so the industry will need to make sure that it continues to automate its production processes wherever appropriate in order to remain internationally competitive.

Conclusions

The food industry in the UK makes an important contribution to the UK economy, particularly in some of the UK’s lowest income areas. In general the industry performs well, showing better productivity growth than the rest of UK manufacturing and higher levels of R&D than the European food industry. Nevertheless, there is room for improvement in productivity, which remains considerably below US levels, and in R&D, which is well below Japan. Furthermore, imports continue to grow while exports decline, albeit in a very competitive international trading environment. The industry has considerable strengths in marketing, logistics and new product development that should enable it to maintain and even enhance its competitive position.

However, there is considerable scope for further improvement, much of it dependent upon better collaboration between industry and Government.

For its part, Government should recognise that a strong food industry is important to the economy and that the industry needs regulation to be timely and evidence-based. It is important to the industry that standards are enforced uniformly across the EU to prevent unfair competition and the British Government should continue to lobby for this.

The UK Government and industry (through FDF) should work with other Member States and bodies such as the CIAA (which represents the European food industry) to promote a sensible EU regulatory environment, continuing trade liberalisation and reform of the Common Agricultural Policy.

For its part, the UK industry must continue to respond quickly to the concerns of society. It must recognise that Government sometimes has to regulate and the two sides’ interests will not always coincide – but a positive approach will always be preferable to a defensive strategy. The Food and Drink Federation, as the industry’s representative body, must play an increasingly central role in effectively putting across the industry’s perspective to the public and ensuring that Government understands the realities of the food sector and works collaboratively with the UK’s largest manufacturing sector.
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Dunn, John (February 2007): Back to the future: Tomorrow’s food sector will remain vibrant, but will have accommodated new priorities.
http://www.foodmanufacture.co.uk/news/printpage.php/aid/4259/Back_to_the_future.html
FAO (2007): Total Food Exports, FAOSTAT.
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About this report’s author

Bruce Traill has been Professor of Agricultural and Food Economics at the University of Reading since 1990 and was Head of the Department from 1999 to 2005. He has previous lecturing experience at the University of Manchester and has worked for the European Commission (for five years). In 2002/03 he led the independent team for the evaluation of the international food standard setting agency Codex Alimentarius for FAO and WHO. He has been a member of International Advisory and Evaluation Boards of Research in Sweden, Denmark and the Netherlands and of editorial committees for several international Journals and has been a visiting Fellow at Cornell, Tufts and Bologna Universities. He is a member of the FSA Academic Economists Panel. He has published widely on issues concerning international trade and competitiveness, food industry innovation, food policy and consumer food choice. His current research focuses on the economics and policy of diet and health.

The Department of Agricultural and Food economics is an internationally acclaimed centre concerned with contemporary food, farm and rural issues in low and high income countries, providing a stimulating education for EU and international students, and undertaking and disseminating high quality research of relevance to society’s needs.

About the FDF

The Food and Drink Federation is the voice of the UK food and drink industry, the largest manufacturing sector in the country. FDF’s membership comprises manufacturers of all sizes as well as trade associations and groups dealing with specific sectors of the industry.

In representing the interests of our members, FDF is focusing on three core priorities: Food Safety and Science; Health and Wellbeing; Sustainability and Competitiveness.

A big thank you

All the pictures in this report were taken in the factories of some our member companies. So a big thank you to Dorset Cereals (our front cover picture), Kraft Foods, Macrae Food Group, Warburtons and Walkers for allowing us to use these photographs.