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MEAT INDUSTRY COMPETITION & CONSOLIDATION IN THE 1990s

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Thank you. I'm glad to have been invited to share with you my perspectives on industry competition, consolidation and prospects for the future. For the purposes of this discussion, most of my remarks will focus on the beefpacking industry, where consolidation and competition have received the most attention.

CONSOLIDATION

During the past 15 years, various governmental and non-governmental groups have examined the beefpacking industry's consolidation. In 1987, both Bill Jones, then head of the Packers & Stockyards Administration (PSA), and the U.S. Government Accounting Office (GAO) in its report on the Purpose, Use, Impact and Regulation of Cattle Futures Markets concluded that there was no evidence that prices and market supply have been affected adversely by consolidation or by increased use of futures markets. They cautioned, however, that consolidation does increase the potential for prices and markets to be affected. A 1989 National Cattlemen's Association study done by independent economists, including my distinguished co-panelist, reached similar conclusions about packing-industry consolidation.

Even more recently, in testimony October 16, 1990, before a hearing of the House Subcommittee on Government Operations, Justice Department Antitrust Division Deputy Attorney General Judy Whalley said the division has not found past industry mergers anticompetitive and that the risk of anticompetitive behavior in meat packing currently does not appear to exist. Whalley noted that the division would carefully review any further mergers.

At the same hearing, Packers and Stockyards Administrator Virgil M. Rosendale testified that a PSA review of packer consolidation found no evidence of noncompetitive behavior in meatpacking.

From Excel's perspective, competition has never been more intense than it is today. As Bill Jones noted for PSA, profit margins in packing had not changed significantly in the 10 years leading up to 1987. At that time, gross margins had remained between 1–2 percent, which is a level of return that is extremely competitive. I can assure you from personal experience that nothing has occurred since 1987 to improve packer margins in either beef or pork processing.

That perspective is supported by the facts in Professor Clement Ward's 1988 book "Meatpacking Competition and Pricing," which confirmed the lackluster margins of profit for meatpackers. His book noted that Forbes magazine reported a median net profit margin for meatpacking of 1.6 percent compared to 3.9 percent for an all-industry median profit margin. That was sufficient profit to rank meatpacking 77th among the 87 subgroups and industries included in the Forbes survey.

In the same Forbes survey, the average return on equity for meatpackers was 11.9 percent compared with a median of 12.6 percent for all 87 subgroups and industries. That placed meatpacking 65th among the 87 categories.

Other industry observers have pegged net profit margins within the beef packing sub-section as consistently below 1 percent throughout the 1980s.

Professor Ward has been among the most consistent and prolific observers of the packing industry. He, like the other analysts mentioned above, is concerned about the four-firm consolidation level within beefpacking but says that so far the evidence shows that the trend is the result of economic realities and has benefited both cattle producers and beef consumers.

A study Ward co-authored earlier this year with Professor Conner concluded that the meatpacking industry is not earning excessive profits, either in absolute terms or relative to other food processing industries.

Dr. Wayne Purcell, director of the Research Institute on Livestock Pricing at Virginia Tech, agrees with most of Ward's assessments on consolidation, but is an even stronger advocate of its positive aspects. Purcell currently reports that with beef demand on a downward slide during the 1980s packer costs increased, but were not passed on to consumers or back to producers. I quote him here: "Middlemen packer/processors were able to grab efficiency, new technology, get bigger and get cheaper to offset a substantial part of the inflationary pressures on their costs. Had that not occurred, the pressure on cattle prices would have been even greater, the herd today would be smaller than it is and beef's market share would be smaller than it is today."

Purcell observed that the actual farm-retail price spread for beef reported by USDA was 86 cents in 1979 and $1.07 in 1988. If that 86 cents was inflated like the consumer price index, the spread in 1988 would have been $1.38. He concluded that if middlemen had not become more efficient, the downward pressure on cattle prices would have been much more intense.

The bottom line of all this is that packers who incorporate new technologies realize economies of scale as they grow and create a much more competitive and efficient meatpacking industry. Producers growing ever smaller supplies of cattle currently are paid more than otherwise would be possible. At the same time, consumers are receiving more varied, wholesome and higher-quality beef products at prices that are more reasonable than would be possible without the packer investments that updated and consolidated the industry.

While I'm talking about benefits, I can't pass up the opportunity to note several additional positive aspects of consolidation. Those studying the beef packing industry seldom mention that major packers have made tremendous investments in ergonomics, employee health and safety measures, food safety and upgrading the work environment. In the process of modernizing plants to ensure future competitiveness, major packers have set standards of practice that the rest of the industry is challenged to match.

For the two fiscal years beginning in June 1989 and ending in May 1991, the top three packers have designated almost 500 million dollars in capital expenditures to upgrade, expand or build newer, better facilities. That translates into designs that include more sanitary beef and pork plants that safeguard workers' health, provide Hazard Control & Critical Analysis (HACCP) monitoring and corrective action and which more completely and responsibly handle environmental concerns associated with byproducts and waste water.

At Excel, we've begun an unprecedented, voluntary ergonomics program in conjunction with the United Food & Commercial Workers Union. That program applies to all Excel plants and was begun without pressure from any outside agency. In the area of food safety, we are making major investments in improved sanitation controls and practices to further assure consistent high quality of beef and pork leaving our plants. And, in recognition of the growing tight supply of good employees, we have begun expanded training and career development programs aimed at retaining employees in an industry that is well known for its high turnover.

Instead of focusing on packer consolidation, the beef industry would be better off focusing on these improvements and seeking new ways of making red meats more competitive with poultry. That was a major conclusion reached by Dr. Conner and his associates in the study done for the National Cattlemen's Association Task Force on Industry Structure.

COMPETITION

The NCA Task Force study called for renewed commitments to research that will lower production costs. The report said that beef seriously trails the pork and poultry industries in production efficiencies, processing and retailing. Vertical integration will not occur to any significant degree in beef or pork as it has in the poultry industry. However, the red-meat industry must develop a model of structural efficiency that all aspects of the industry can work on together to establish programs that will improve efficiency. Checkoff funds for advertising will do little to increase consumption until beef prices and products become more competitive.

Dr. Conner has or will cover those points better than I can. I do want to emphasize, however, that I concur with the study's conclusion that price competitiveness has been the overriding factor influencing beef's share of consumer dollars. While some have attributed loss of market to dietary and health factors, we know from the NCA study that only 2-3 percent of consumption loss is directly attributable to those factors.

The NCA Task Force report also stressed the importance of research into and development of more accurate price-discovery mechanisms and international export markets. Those recommendations point the way to future growth in beef consumption. A significant factor in cutting production costs and providing products consumers tell us they want would be to eliminate production of excess carcass fat.

One result of the Industry Structure Task Force was formation of the NCA Value Based Marketing Task Force. That group examined ways to put action some important production cost recommendations made by Dr. Conner's group.

I think one of the most important goals expressed by the Value Based Marketing Task Force was the need for "improving production efficiency by reducing excess trimmable fat by 20 percent and increasing lean production by 6 percent by 1995, while maintaining the eating qualities of beef." Task force calculations showed that the beef-production industry currently is spending about 2 billion dollars to produce waste fat that must be trimmed off at the packing plant or at the retail meat department. That amounts to about $170 per head in excess production costs.

But the real goals of the task force are more far-reaching than a short-term gain in lean-to-fat ratio. Consumers told our industry in 1986 that they wanted beef cuts trimmed more closely of exterior fat. The problem has been that retailers have continued to buy beef on the same old basis, simply trimming fat and throwing it away as a cost of doing business. The Task force recommended a retailer-education program that is scheduled to begin yet this year. In a nutshell, the program to reduce fat consists of eight points that emphasize retailer and producer education and incorporate new price-discovery mechanisms. Those points are:

Communicate Value--educate retailers about the value of pre-trimmed beef so anti-fat signals will go to packers.

Offer Trimmed Beef--packers are to offer retailers pre-trimmed beef as an option, so the anti-fat signal goes back to feeders.

Develop New Packaging--solve packaging problems so fat can be reduced via case-ready products.

Define Consumer Needs--research consumer needs further to give cattlemen guidance on how to gear production.

Research Grades--determine if there is an alternative to the degree of emphasis placed on the Choice beef grade.

Develop Electronic Grading--make grading more objective to increase rail selling by producers.

Carcass Value Pricing--enhance the flow of information on carcass value to promote the trimming of fat genetically.

Develop Breed Carcass Profiles--breeders need tools for finding seedstock able to transmit superior carcass characteristics.

Industry trade publications have dubbed these recommendations a "Declaration of War on Fat." I believe that is accurate, and they certainly are positive steps toward taking action on the production competitiveness of the beef industry. Following this eight-step strategy will set the tone for future competitiveness.

I'd like to spend the remainder of my time addressing prospects for the future.

THE FUTURE

The NCA Task Force study suggested that export markets represent a great area of growth potential and that is certainly true. I'll review that situation in a few moments. However, I believe the beef industry and red meat industries in general must concentrate first on market economies that are highly developed. The most highly developed and well-to-do population is here in the United States. Programs and products must be developed cooperatively by all segments of the beef industry.

Often individual segments respond by saying, "That's not my job, I grow the cattle, the packer and retailer have to market them." However, it is their product and livelihood at risk. I believe our industry is doing a better job of cooperating to market beef today than it was five or 10 years ago, but we have miles to go to catch up to the poultry industry.

Per-capita beef consumption in retail cuts was 68.9 pounds in 1989, down from 72.3 pounds in 1988. That's down from the high of 88.9 pounds in 1976. Consumption is a factor in demand, but more importantly it's a measure of supply because what is produced is eaten at some price. Beef cattle prices have been good only because supply is tight. So, record prices in the $80 range for fat cattle and near record prices near $90 for feeders don't signal a return of demand.

To trigger demand, the red-meat industry must focus U.S. efforts on developing convenient and price-competitive beef, pork and lamb products. The real test of whether consolidation in the beef industry provides more than short-term benefits for producers, packers and consumers will be when profit levels for packers are sufficient to fund product research and development. It is then that new products are most likely to be created. If the R & D investment is not made, then consolidation may have to be viewed in a less favorable light. Although packers may finance product development research, it's up to the entire red-meat industry to implement research results.

I'm talking about expanded industry cooperation all the way back to the farm level that tailors products for consumer demand. It needs to happen not just on the cutting floor or research laboratories of packing houses but all the way into feedlots and herds. That's how the industry collectively can attract the market basket dollars of disenchanted U.S. consumers.

At Excel, we've already introduced a "Perfect Trim" program that offers meat wholesalers and retailers meat cuts with reduced exterior fat and case-ready vacuum-packaged Excel Brand beef. We've also done considerable research on identifying characteristics of cattle that are needed to meet consumer demands and instituted a beef specification system based on that research. These and numerous other efforts are expensive but we believe in them because they will contribute to the benefit of the overall meat industry, and beef in particular.

On the export front, there has been considerable progress. With only about 4 percent of U.S. beef production flowing into export channels, there is certainly room for more U.S. exports, but the competition will be tough. In 1989, exports accounted for 850 million pounds of carcass weight, or 3.7 percent of total U.S. production. That was worth a record 2.1 billion dollars.

The area of greatest potential in exports are Pacific Rim nations, led by Japan. The Japanese already are the number one market for U.S. beef exports, with 180,000 metric tons shipped there in 1989. Full liberalization of Japanese beef trade restrictions next April is expected to keep export totals climbing.

Another export bright spot is South Korea, which by mid-May of this year had imported 50,000 metric tons of a 58,000 metric ton quota for the full year. Officials of the U.S. Meat Export Federation report that South Korea's appetite for beef is stronger than that of the Japanese. They predict that when complete markets are fully open to imports in 1997, South Korea could become the number one U.S. customer. Exports to Mexico also have been growing.

If the European Community can be persuaded to stop its prohibitive non-tariff trade barrier protection of livestock producers, that area of the world represents a sizable market for U.S. byproducts, and perhaps quality meats.

Further penetration of these export markets will not be easy. The Australian and New Zealand livestock and packing industries already have developed packing plants devoted to meeting specific product requirements of the Japanese market. Australia exports fully 45 percent of all beef produced in that country. To do so, it devotes facilities, research and product development funds well beyond the amounts currently alloted by U.S. check-off programs.

Despite Australia's lead in plants dedicated to Japanese products, the United States currently provides 43 percent of all beef imports by the Japanese. As liberalization of trade helps reduce the price disadvantage of imported beef, Japanese demand for U.S. beef definitely will grow. Australia is expected to increase it beef feedlot operations and will be very aggressive in pricing grass-fed beef products. To maximize growth in U.S. exports will require careful identification of the markets the industry wants to pursue, keen recognition of competitively priced products and the preferences of consumers relative to U.S. products.

However, development of overseas markets for U.S. beef in countries with developing economies is a long-term process. The first priority for market development should be the United States, where the amount of per-capita disposable income already is conducive to eating higher off the food chain.

That's a rather hurried view of my perceptions of U.S. meat industry concentration, the focus of competition and prospects for the future. I'll try to answer questions if you have them.

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