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**SWP 29/89    CHANGES IN THE EUROPEAN FOOD  
PROCESSING INDUSTRY:  
THE CONSEQUENCES OF 1992**

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## CHANGES IN THE FOOD PROCESSING INDUSTRY IN EUROPE

### 1: INTRODUCTION

There is considerable debate about the meaning of "1992" and its potential impact on business and competitive behaviour across Europe. Some perhaps imagine that it will be a signal event heralding wholesale change throughout the European business structure. Others may dismiss it as yet another piece of "Eurocracy" destined to disappear in the dustbins of time. On balance the latter group (the cynics) are perhaps outnumbered but nevertheless the issues of just how business attitudes and behaviour might change and evolve are not necessarily very obvious. In addition to this contemporary concern with the impact of the 1992 directives there is a longer standing concern among academics as to the nature of industry evolution, its prime causes, the mechanisms, and its unfolding over time. There is developing a concern with business history, with structural change, and with the strategic consequences.

The food processing industry in Europe appears to be one of those industries with a European structure permissive of change or evolution as well as one whose fundamental conditions might be changed by the 1992 directives. This research study is intended to assess the nature of the industry across Europe, its internal dynamics, and in particular the ways in which the 1992 directives might shape its future development.

This particular paper represents an interim report in which we present some of the issues concerning industry evolution, their general applicability to the food processing industry, together with an initial review of the industry and its apparent growth trajectories. The data presented here is largely UK in origin and cross sectional in character. The next stages of the work will extend to the other EC countries and be more dynamic in character. Section 2 discusses the evolution of the food industry, and section 3 looks at the current industry structure and its implications.

### 2: LONG TERM DEVELOPMENT

Porter's (1980) popularisation of the competitive strategy framework laid some emphasis on the evolution of industries and the triggers behind such long term shifts. This, however, has been a relatively neglected issue both in the academic and more practitioner-based writings. Porter correctly emphasised the need for a dynamic analysis of industries but it has been that static analysis of industry structure that has received most attention. The long term development and evolutionary paths of industries and markets

can and have been chronicled historically but not much attention has been paid to the linked activities of triggers of change, strategic moves and positioning, and the tactical exploitation of the newly developed positions. Static analysis can by itself fail to read fundamental shifts - these occurring on time horizons too long to allow discernment over the shorter period. It can therefore confuse the tactical development and exploitation of competitive position with longer term strategic thinking. The essence of strategy (following Rumelt [1974]) is the creation of idiosyncratic assets protectable from short term imitation by competitors. Such asset creation is a long time in the making. The conception, the planning, the implementation are typically expensive, irreversible without non-trivial cost, and time consuming. Subsequent exploitation of these assets may call for competitive re-positioning from time to time, and certainly requires an elaborate tactical paraphernalia in which the investment is also non-trivial. Such exploitation is, however, contingent on the underlying idiosyncratic assets and on their appropriateness over the long term development of the market place. Where the asset position becomes progressively inappropriate it is common to see substantial efforts over the short period to extract further rents - i.e. the tactics take the strain. It is also common to observe various forms of re-positioning activity masquerading under the heading of strategic change - these represent at best minor refurbishments of the outworn asset base.

Any analysis of industry structure and the interplay between competitors requires a careful understanding of the evolutionary path of the industry in question. Where, in particular, we see (by common consent) some far reaching changes in the terms and conditions of trade (such as the completion of the internal market in Europe) coupled with high market growth rates and shifts in the nature of markets then we might look for shifts in the underlying industry conditions. Our argument is that the food processing industry can be seen to have passed through a number of phases each with its own particular characteristics calling forth different business concepts and allocation of resources. Thus the industry has seen a period of wholesaler domination (see Kaldor [1980]), followed by manufacturers' domination in the sixties - the period of the scale economy brander (see Foy [1980]), then the rise of the retailer in the seventies (see Segal-Horn and McGee [1987]), to be followed it is said by a new era in which the consumer is expected to be king. This section looks at these periods (excluding the pre-war wholesaler period) with a view to establishing the underlying changes associated with the current period leading up to the completion of the internal market in Europe. The changes in prospect will be determined by these fundamental shifts and should not be confused with the welter of shorter term competitive positioning and

tactical adjustments which are inevitably the greater as players in the markets strive for short term adjustments to cope with imperfectly perceived shifts which are longer term and more fundamental in character.

## 2.1 The Scale Economy Brander

The consumer packaged goods industries (including the food processing industry) enjoyed halcyon days in the sixties (Foy identifies the period as 1960-74) when manufacturers were dominant. This was a period when mass markets in processed foods were growing quickly, retail distribution was highly fragmented, economies of scale were available, and processing technologies were proprietary. These substantial economic advantages were buttressed by the creation of mass marketing systems comprising national media advertising, national sales forces, and increasingly sophisticated marketing support services. The visible output of this business system was the brand, the repository of guarantees to the customer of product qualities arising from proprietary technology. The creation of the brand was subject to many economies of marketing scale, and fostered scale economies available elsewhere in the system. The brand was the visible symbol of the manufacturers' strength, and was the visible barrier to entry behind which grew a series of oligopolies earning monopoly rents. Foy (1980) described seven competitive (entry) barriers around the brand in the 1960s.

1. National sales force and distribution : "filling up the backroom and stealing shelf space";
2. Listing muscle : fragmented retailers felt they had to stock the leading brands on manufacturers terms;
3. Intensive media advertising bought at preferential rates and defrayed across large volumes;
4. Superior product quality arising from proprietary processing technology and/or from consumer perceptions;
5. Low cost processing either from superior technology or from scale economies;
6. Sophisticated support services e.g. market research, product management support structure, advertising skills;
7. Discounts on raw material purchases based on volume.

Branding economics was all about the premium prices, the consumer pull, and economies of scale. The association of market share and profitability was well attested in this regime of the scale economy brander. Behind the brand lay a

technology edge and a new management structure and style - the style of the marketing company.

## 2.2 The Rise of the Retailer

The heyday of the scale economy brander (the late 60s) was, however, a period in which the seeds of change were already evident. The large retailer was becoming more and more significant in the market. His position was fostered by the abolition of Retail Price Maintenance in 1964 allowing retailers the opportunity to compete on price. Furthermore processing technology was diffusing and becoming less proprietary. Quite suddenly the balance of power shifted from the manufacturer to the retailer, just as in the 1930s it had shifted from the wholesaler to the manufacturer. The emergence of large scale national retailers made for dramatic change. The consumer was now faced with a new proposition. Price-led competition was supported by an outlet brand (as distinct from a product brand). This was furthered by the entry of smaller scale processors who could now find ready customers in the private label retailers and whose access to technology and to efficient plant was not deterred by proprietary technology. In addition retailers began to reorganise the inward logistics of their business thereby diluting the distribution economies of the major manufacturers and making it possible for further specialised new entry. The emergence of national accounts diluted also the national sales forces of processors and undermined their product management structure.

The scale economy branders found their entry barriers substantially undermined (or hurdled?). Many of their significant overhead costs (sales force, distribution network, support services) were less directly useful, and were defrayed over lower volumes; their product brands were challenged by retailer brands, their product quality was less obviously pre-eminent; manufacturing had not only suffered from neglect in marketing oriented companies but its technologies and procedures could be effectively copied in smaller plants; and to cap it all retailers were increasingly demanding and obtaining quantity discounts which they used to further price competition, not only reducing manufacturers' margins directly but indirectly eroding their brands by fostering price competition. (Table 1).

Table 1 Value of special terms negotiated with retailers as a percentage of total sales (1983)

Product	Sales to top 10 customers (%)	Own label sales (%)	Special terms (%)	
			To all	To top 10
Baked beans	40-65	21	6.8	7.5
Biscuits	45	17	10.6	12.4
Bread	45	20	Not disclosed	
Flour confection.	50	21	6.7	8.0
Canned beer	c.34	2	9.4	12.8
Cigarettes	15	Very small	1.8	3.7
Paint	25	10	Not disclosed	
Toothpaste	50	5	8.1	9.1
Paper tissues	70	23	11.2	n.d.

Source: OFT (1985, pp. 44-54), Grant 1987, p.50.

This story is familiar. There was considerable variance across sectors within food processing. In some instances the brand has been well protected - the entry barriers have held up well (e.g. breakfast cereals). The point of the story is this. There are triggers for change. These provoke major strategic shifts. These strategy changes are promoted by a series of (new) tactical moves. They are resisted by incumbents by a series of ripostes essentially tactical in nature, often moving from a reiteration of familiar tactics through a realisation of the nature of changed circumstances to major strategic shifts by the incumbents themselves.

In this case the triggers were partly evolutionary and partly exogenous in nature. The evolution was that of supermarkets, the possibility of economies of scale in retailing and its implications for price competition in distribution - a new possibility. This was fostered by the abolition of RPM an event which ushered in the new era although it is noteworthy that it took some ten years\* for its full weight to be appreciated. In addition to the active forces for change there is the erosion of position to take into account. Distinctive competitive advantage erodes as competitors learn and as knowledge diffuses. Even without exogenous forces for change the internal dynamics of

\* Around 1974 both Sainsbury and Tesco began their drive to become national retailers.

change will force realignment and evening-out of competitive position.

The strategic changes were evidenced by the retailers and by the new entrants into food processing. The major change was the concentration of retailing as the majors built larger and larger outlets, concentrated on price competition, and steadily widened their businesses to include distribution, branding, research (a little) and development (much more), and wider and wider product ranges. The retail trade was able to turn brands into commodities, to brand themselves rather than their products, and was able to gain very substantial efficiencies. Strategic change in retailing was bound to have very substantial effects on the strategic position of manufacturers.

The secondary strategic change arose from the erosion of the "edge" of manufacturers. New, smaller entrants were increasingly able to perform many of the same functions. The interlopers essentially cherry-picked the vertically integrated processors. This vertical integration was originally an entry barrier by virtue of the capital requirements implied. It became a strategic disadvantage because of the high costs of each of its component parts each of which was facing vigorous and progressively more efficient competition.

In general, the reaction of incumbent processors divides into three stages. First is the increased emphasis on familiar marketing tactics to re-assert the brand and its power with the consumer. Second, comes the cost cutting as the high fixed cost base becomes more and more embarrassing. Shortly after comes the first attempts at re-positioning with new product development, product range extensions, revisions, and trimming. Eventually may come more fundamental attempts to re-define the business in the new circumstances of the industry.

### 2.3 The European Dimension

If the period from 1960-74 showed manufacturer dominance, and 1974-1986 represented the power of the large retailer, then what are we to make of 1987 onwards? The fall of manufacturers' brands was triggered by structural change in retailing along with other shifts within the manufacturing value chain. Triggers of change are usually single dramatic events. However, in practice major changes spring from small seeds and gather momentum overtime. The flowering of the new is paralleled initially by apparent prosperity of the old, as indeed was the case in the 1960s when manufacturers were prosperous but retailers were gathering strength. Other industries show similar patterns (see Ghazanfar [1985] on reprographics and Jones [1986] on automobiles). Changes in industry structure divide into two

broad patterns, the continuous and therefore predictable and expected, and the discontinuous (see Ansoff [1965]). Discontinuity can arise from an expected change proving unexpectedly powerful and all embracing - a shift in the pace of change. It can also arise from totally unexpected events such as legislation, new discoveries and so on. Very often major discontinuity is fostered by a conjunction of these effects, thus in the 1960s the shift came out from legislation (RPM abolished), accelerating power of retailers (fostered by the abolition of RPM), and the natural forces of knowledge and skill within the manufacturing sector.

### 1992 and All That

In looking forward to the 1990s, therefore, we should be seeking a conjunction of exogenous and endogenous forces, and the links between independent events and those events consequential on the independent. The projected completion of the internal market in 1992 is an independent event exogenous to the industry capable in principle of transforming the playing field and the rules of the game (MAC [1987]). The intent is to proceed towards a common market in which goods, people, services, and capital can move without obstacle, just as envisaged in the Treaty of Rome 30 years ago. The essence of the Commission's initiative was some 300 measures (about 20 of which have been dropped) to be adopted as directives (European laws) by the ends of the present commission's reign in December 1992. These directives focus on practical measures such as labelling requirements and inspection procedures rather than on statements of principle. The challenge for companies is to respond in operational terms to these specific changes rather than undertake political lobbying procedures designed to protect them from the practical applications of general principles. The graspable notion is that the conditions of the market and of competition will change. The imponderable is how much and where it will all lead. As the Economist (1988) observed:

"part of the power of 1992 is that it is so hard to reduce to essentials ... 1992 has become a state of mind, a set of expectations that has political force, an obsession that amounts almost to a new reality."

Existing EC food law defines detailed requirements on the composition of specific foodstuffs. These have proved difficult to agree, are quite complicated and are full of numerous national exceptions (derogations). There are no plans for extending these directives on food composition further. Instead the proposed legislation will concentrate on a more informative system of food labelling and on setting general food safety and hygiene standards.



Appendix A lists the coverage of the four "framework" directives together with other measures under consideration (from DTI 1988). The first of these removes the scope for national derogations from EC rules. This might mean, for example, that the restriction on using aspartame in soft drinks in France may be disallowed. The second concerns the criteria for evaluating and labelling food additives. This might affect, for example, the German beer purity law which stipulates that beer containing substances other than hops, malted barley, yeast, and water cannot be sold in Germany. The third directive concerns materials and articles in contact with food. The fourth covers harmonisation of food labelling requirements by ending the national exceptions. According to the MAC report (1987):

"nearly every EEC country operates with different label requirements, which implies that an EEC producer is effectively prohibited from using a uniform label for its EEC sales. The amount of information required on the label varies from country to country ... Exhaustive requirements like this ... form a subtle but effective barrier to trade."

At first sight these may seem to be unpromising triggers for major change. The MAC report examined trade barriers in ten product sectors identifying over 200 barriers (not all of which would be subject to removal by the new directives). MAC estimate that the quantifiable direct benefits of removing these barriers are themselves significant amounting to 2 - 3% of industry value added. But they go on to say that the indirect net benefits would be larger. These would be:

1. the broadening of consumer choice;
2. a significant increase in trade;
3. efficiency gains;
4. improvement in the competitiveness of EEC food companies vis-a-vis the rest of the world.

Any estimate of the indirect benefits is necessarily controversial. MAC estimate that there would be moderate to large increases in imports (i.e. in intra-EEC trade). In particular the beer market in West Germany and the pasta market in Italy could see imports rising from negligible levels to 3-5% of domestic consumption. The German beer industry also shows striking potential for industry restructuring. There are (MAC 1987) currently about 1200 breweries in Germany accounting for 75% of all breweries in the EEC. Some closures are already taking place.

The MAC report concludes:

"The existence of trade barriers ... has served to protect potentially weak domestic companies, and inversely, has encouraged strong companies to expand domestically rather than attempt cross-border expansion. These features of trade barriers have reinforced the relative fragmentation of the EEC food industry. Removal of these barriers should decrease or eliminate these tendencies".

### Endogenous Factors

While these and other estimates of the benefits are high, they are cumulative, long term, and are extrapolated from just a few product sectors. Reverting to the views articulated in the Economist, the tangible opportunities from the four directives are immediate but not necessarily impressive in the short term. Their longer term impact will be viewed against the opportunities offered in the markets of Europe, in particular the potential for serving homogeneous consumer segments across Europe.

Riesenbeck (1988) argues that (1) national markets are becoming saturated and life cycles of competitive advantages are shortening forcing companies to segment more finely and concentrate on acceleration of new product development, (2) there is an increasingly international orientation of consumers and a growing homogeneity of demand around the world, (3) the importance of international sourcing is rising, and (4) that entry and exit barriers have been reduced as the level of fixed assets required has fallen. These views are redolent of Ohmae (1985) and Levitt (1983), but apply specifically to the food processing industry. The next section examines these propositions in some more detail. However, taken in conjunction with the decreasing importance of national laws, regulations, and tastes and the freeing up of capital markets (see Exhibit 1) we have an impressive a priori case for changes in structural conditions and a shift towards a more "European" industry.

If indeed the structural conditions are changing in this way then we can expect a series of strategic adjustments by companies. Exhibit 2 illustrates the choices. The internationalisation of consumer segments is an autonomous and accelerating trend (by hypothesis) fostered further by the completion of the internal market. (Some) Companies will therefore be targeting more specific socio-economic groups and regions integrating their marketing across regions - in contrast with the majority of packaged goods multinationals who presently run their international operations as a portfolio of national strategies (Ramsay

1988). Alongside this new orientation to markets will be a new attitude to manufacturing. After a long period of diffusion of knowledge and experience a new wave of technology is beginning to appear. A number of different strands are visible. First, many manufacturers are searching for plants flexible enough for a wide product range so as to serve fragmenting markets. Others are looking for single scale efficient sourcing for European markets. Finally, there are those seeking for new products from the advent of new technologies (such as membrane separation in dairy products).

Thus, in addition to market choices, there are significant manufacturing plant and product range choices to be made. Within this Ansoff-style product market matrix can be encompassed the range of potential strategies, some new, some not so new. Alongside this matrix in Exhibit 2 are listed some of the possible routes by which this product-market positioning could be achieved.

In our view there will be two main strands to the new evolutionary forms of the food industry. The first will be a restructuring, consolidation, efficiency-seeking change of the kind posted for the German beer industry. There will be a large reduction in numbers of plants and numbers of companies. There will be some simple closures and re-allocations of production within firms. There will be a spate of acquisitions of companies with distinctive assets such as brand names or distribution (but probably not manufacturing). Many small and smaller firms will be compelled to exit. The driving force in this scenario is the search for low cost through efficiency in production, distribution, and marketing. By itself this might not be so dramatic but for the strong possibility of new forms of competition based on new segmentation, branding, and new products. So there will also be a premium on the rediscovery of marketing facilitated by joint ventures (products for markets, for example), and swaps of facilities to round out product lines and segment portfolios. The conjunction of efficiency seeking with marketing and product (and new technology as well?) innovation is likely to prove complex and highly disturbing. In the new structure as it stabilises there are likely to be many simultaneous strategic groups co-existing with some comfort. But in the evolution towards this there is likely to be a great deal of confusion and experimentation as companies seek for new understandings and new positions. The next section looks in some more detail at the initial structure and some of the likely moves over the short term.

### 3: THE EUROPEAN FOOD PROCESSING INDUSTRY : AN OVERVIEW

This section first provides a brief economic and statistical overview of selected key features of the European food processing industry. Secondly, it discusses the pressures for change and their impact on the existing structure of the industry.

#### 3.1 Sectors and Products

Food processing is an industry containing a large number of sectors, encompassing a wide range of products and processes. A common breakdown (Nicholls, 1978) is into eleven segments as follows:

- breakfast cereals, bread and flour
- cakes and biscuits
- processed meat
- processed fish
- dairy products
- sugar
- chocolate and sugar confectionery
- processed fruit and vegetables
- non-alcoholic beverages
- other food products
- alcoholic drinks

Across these sectors the food industry contains three types of firms: agricultural suppliers; "primary" processors, who turn crops into usable food products such as sugar or flour; and "secondary" processors who produce every kind of refined food product from ice-cream to sausages. Together these three types of companies make up the biggest manufacturing industry in the EC. This paper concentrates mainly on the "secondary" processors, the diversified food product companies.

With the changes now in progress in the EC's regulatory structure, the very considerable effect of the CAP (Common Agricultural Policy) on the European food industry both in terms of raw material prices and terms and conditions of trade in processed food products, is likely to be tackled at last, albeit very slowly. The CAP has raised the price both of the European food industry's inputs and of its sales. Unlike the guaranteed prices (MCA's - Monetary Compensation Amounts) paid to most primary processors, the secondary processors must pass high input<sup>costs</sup> on to consumers and are not allowed to use cheaper foreign farm products. High input prices must be expected to affect demand for processed foods (e.g. ready-made cakes), since they are discretionary purchases. Therefore a longer-term outlook for smaller

output and lower prices in the farming and primary sectors as a result of CAP reform, creates an improved cost position for secondary processors. Long-term technical advance and agricultural productivity have generated increases of 1.5% to 2.0% per year over the last 25 years, while consumption has increased by only about 0.5% per year in the same period (Swinbank and Burns, 1984). In real terms, average expenditure on food for Europe as a whole was only 7.3% higher in 1986 than in 1975 (Financial Times/GIRA, 1988) whilst in the richer EC economies such as West Germany, Netherlands and UK, the proportion of income spent on food is declining (Table 2).

Table 2 UK consumer expenditure on food as % of disposable income (%)

1970	23
1975	19.8
1978	17.9
1981	15.5
1986	13.8

\*Source: MAFF, Annual Food Statistics

Lower input prices combined with changes in demand towards higher value-added products, should help to provide growth within a mature industry. It is processed rather than basic food products which are the growth segments, with three dominant forces driving demand - healthy eating, indulgence and convenience. The more pragmatic approach to standards being taken since 1985 (based on "mutual recognition" rather than "harmonisation") to dismantle technical non-tariff barriers to trade across EC boundaries, should also have a positive effect on growth in EC-wide consumption of processed food products. From a variety of such non-tariff barriers, MAC estimated the most benefit to the European food and drinks industry "on the order of 2-3% of total industry value-added" (MAC 1987) would be derived from the removal of just six types:

- restrictions on the use of vegetable fat in chocolate
- restrictions on the use of vegetable fat in ice cream
- restrictions of the use of plastic containers
- limits on the alcohol content of beers
- beer purity laws
- pasta purity laws

This is roughly equivalent to the claims made by the European Commission where the gains to EC nations from the removal of barriers to trade and production is estimated at

between 2.2-2.7% of total GDP (Cecchini, 1988; European Commission, 1988).

### 3.2 The major European competitors

Although the industry is commonly regarded as structurally fragmented, the structure varies enormously between countries and product sectors. For example, in the UK, 80% of beer comes from 7 breweries and 62% of biscuits from 2 companies. By comparison West Germany had 10 times as many breweries and 7 times as many bakeries (Swinbank and Burns, 1984). However, productivity has traditionally been higher in the smaller German plants than the larger UK operations because of prolonged poor levels of investment.

There are also a great number of small firms, e.g. the UK has 5,000+ firms with less than 200 employees, but the large mass of small companies make only a small contribution to total output. Many of the large firms in this industry are diversified not only across several sectors of the food and drink industry, but also into related service industries such as restaurants and hotels. These companies are multi-product, multi-process and multi-business. They are capital-intensive and technology-dependent.

Table 3 Major European food companies (by turnover)

(see end of text)

IGD's enumeration of the largest food processors in Europe shows the remarkable domination (in size terms) by UK companies. Our own estimates support this (see Table below) showing 38 UK companies in the top 100, and 26 in the top 50.

Table 4 Largest Food Companies in Europe

	1987		
	<u>In top 100</u>	<u>In top 50</u>	<u>In top 20</u>
UK	38	26	14
France	20	9	4
Holland	12	7	1
W. Germany	11	4	0

\* Source: authors estimates IGD

### 3.3 Conduct and Performance

Although recently leading firms have not shown significant gains in specific markets, their overall strength and opportunities for firm-level economies - e.g. in advertising, R & D, information and marketing - may have

increased. Cross-subsidisation of products in markets where competition comes from smaller rivals can often mean that the firm with the "longest purse" may eventually secure market dominance (Burns, McInery and Swinbank, 1983). Similarly, it is commonly held that the major consequence of increased retailer buying power has been pressure on manufacturers' profits. Yet despite large food processors being squeezed between high EC-policy-induced raw material prices and very strong bargaining power by the retailers at the distribution end, margins are recovering and currently improving.

Table 5 Net profit margins for U.K. food manufacturing and retailing % sales: historic cost/(current cost

	Food manufacturing		Food retailing
	(a)	(b)	
1975	5.2	3.9(-0.6)	3.6
1976	6.0	4.2 (0.1)	3.3
1977	5.3	4.6 (0.4)	3.9
1978	5.0	4.0 (1.1)	3.1
1979	4.7	4.4 (1.3)	3.0
1980	4.4	4.1 (0.9)	3.0
1981	4.3 (2.6)	5.0 (3.1)	3.0 (2.5)
1982	4.2 (2.6)	4.8 (2.5)	3.1 (2.7)
1983	4.3 (2.8)	4.9 (2.8)	3.4 (2.8)

(a) Source: Bank of England/Datastream

(b) Source: Institute of Grocery Distribution

\* Source: OFT 1985, Table 15

However, U.K. statistics suggest that investment is not increasing much, if at all, and that R & D has fallen significantly

Table 6 Investment expenditures: (fixed capital expenditures as % of previous year's gross capital stock)

<u>United Kingdom</u>			
	<u>All manufacturing</u>	<u>Food manufacturing</u>	<u>Retail distribution</u>
1976	3.6	3.9	5.3
1977	3.8	4.6	5.9
1978	4.0	4.7	6.2
1979	4.0	4.6	6.7
1980	3.4	4.0	5.7
1981	2.5	3.5	5.1
1982	2.4	3.7	5.0
1983	2.4	3.4	5.5
1984	2.7	3.9	6.1

\* Source: OFT 1985, Table 16

Table 7 R & D expenditures by private industry (U.K.) (£m. 1975)

	<u>All manufacturing</u>	<u>Food, drink &amp; tobacco</u>
1972	1,257	42.1
1975	1,172	47.7
1978	1,373	52.3
1981	1,420	36.6
1983	1,330	27.0

\* Source: OFT 1985, Table 17

The industry is characterised by economies of scale in manufacturing, high levels of fixed costs arising from R&D, marketing (especially advertising) and distribution. Value added ranges from 45% to 65%. (Tables 8 and 9 illustrate).



Table 8 Average cost structure of manufactured food products (1970s)

£1.00	Manufacturers' selling price
.04	Profit
.11	Other costs
.05	Distribution
.15	Labour
.10	Packaging
.55	Raw materials

\* Source: Food Manufacturers Association/Jordans, 1985

Table 9 Cost structure for a standard (25g) packet of potato crisps

.09	Profit
.05	Advertising and promotion
.18	Distribution and marketing
.18	Manufacturing and labour
.15	Packaging
.35	Raw materials

\* Source: Vickers da Costa Research/Jordans, 1985

Over the 10-year period 1973-83 raw materials costs have fallen from an average of 51.9% to 43.9% reflecting the general increase in value-added in the industry.

#### The Importance of Brands

The importance of brands in the food industry cannot be overemphasised. National branding is the traditional source of competitive advantage and brand share is commonly associated with superior profitability (see below). The size of national retailers (in the UK at least) has substantially eroded the strength of many, but not all, brands, replacing product branding with their own form of outlet branding (private labelling). However this is more evident in the UK than elsewhere. In general, manufacturers' brands remain significant, but are focussed on national markets. For example, IGD calculates that there were 22 food manufacturers in the top 100 advertisers in the UK in 1987. Their total advertising spend is estimated at £344 million and increasing.

Table 10 Return on investment for different brand positions

Brand rank	ROI
1	18%
2	3%
3	-1%
4	-6%

\*Source: PIMS Database

The MAC report (1987) shows that out of a sample of 46 EC-based food companies, one-half have a presence in two EC countries or less.

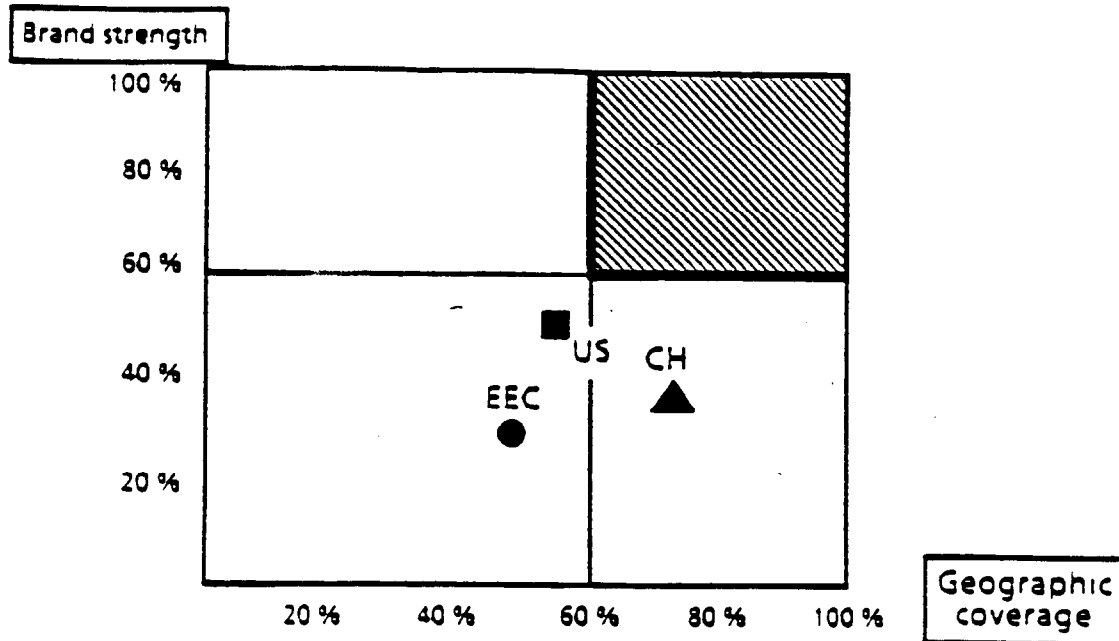
Table 11 Average major countries per product line for EC-based companies

1 country	6%
1/2 countries	44%
2/3 countries	24%
3/4 countries	17%
> 4 countries	9%

\*Source: The MAC GROUP, 1987

Building the geographic coverage of key brands is held to be of increasing competitive significance. It lies behind the pattern of acquisitions, disposals and "swaps" which is well advanced amongst US food companies and strongly under way in Europe. As indicated by the table below, the US food companies are significantly further advanced than the Europeans in both brand strength and geographic coverage, whilst the Swiss are significantly stronger in geographic coverage.

Table 12 Brand strength/geographic coverage for EC v. non-EC-based companies

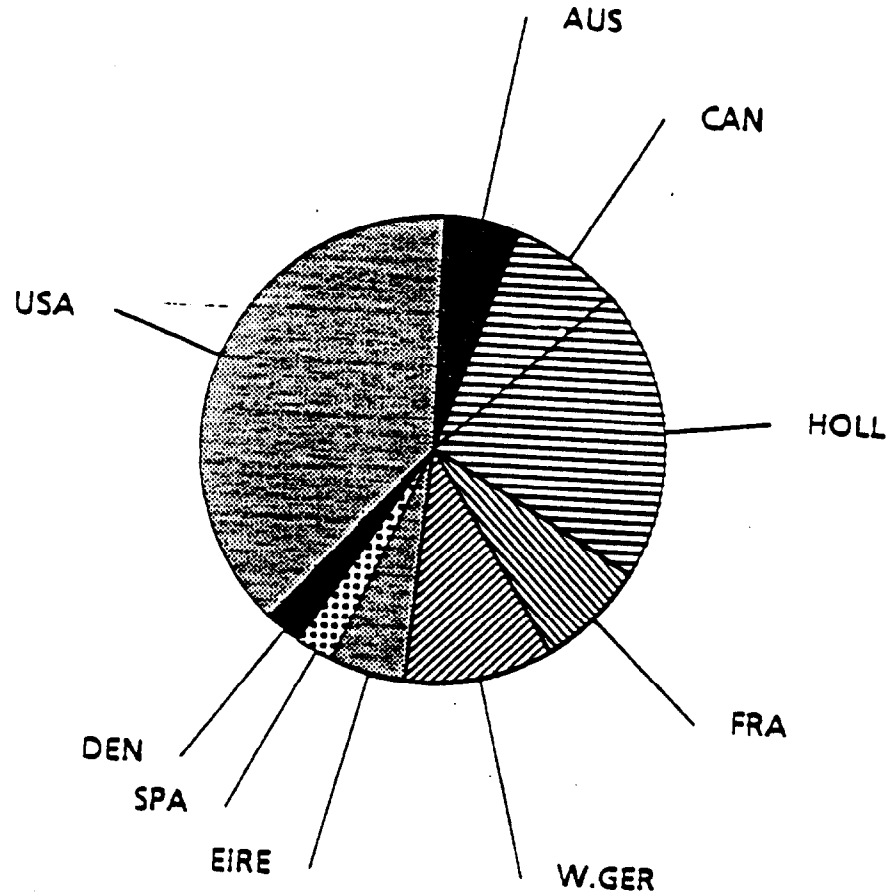


Acquisitions and Mergers

In the UK, the number of acquisitions in the economy rose substantially in 1987 (50% up on 1980). £15.4bn was spent on 1,125 acquisitions in 1987 (in 1986 - £14.9bn on acquisitions). According to (narrow) Government definitions, in food manufacturing the value of acquisitions was £449mn from 36 companies in 1987 (compared to £356mn from 45 in 1986). IGD taking a wider definition counted 78 acquisitions made by 34 companies in the period January 87 to March 88, with a value of £719mn (see Appendix 1).

At the start of the 1980s, there was a major burst of acquisitions and expansion into North America. The USA still remains the single most popular area with 15 of 39 foreign acquisitions recorded there (see Figure 1). However in the last fifteen months half of all foreign acquisitions by UK food manufacturers were in Europe. (See Appendix 2).

Figure 1 Origins of Foreign Companies Acquired by UK Food Manufacturers



\*Source: IGD Research

Of prime significance are the megabids (see Appendix 2) i.e. acquisitions of over \$1bn (Table 13).

Table 13 Recent major acquisitions over \$ 1bn

Year	Acquiring Company	Country	Sector	Target Company	Country	Sector	Price \$m.
1984	Beatrice Foods	USA	Diversified food prods.	Esmark	USA	Diversified food prods.	2840
1984	Nestle	Swiss	Diversified food prods.	Carnation	USA	Dairy/div. food prods.	3000
1985	RJReynolds	USA	Tobacco	Nebisco	USA	Biscuits/canned foods	4907
1985	Philip Morris	USA	Tobacco	General Foods	USA	Diversified food prods.	4750
1985	Hanson Trust	UK	Diversified products	Imperial Group	UK	Food & tobacco	2800
1986	Guinness	UK	Brewing	Distillers	UK	Spirits	3481
1986	Allied-Lyons	UK	Diversified food prods.	Hiram	UK	Spirits	1860
1986	Coca Cola	USA	Soft drinks	BCI Holdings	USA	Battler	1000
1986	Coca Cola	USA	Soft drinks	JTL Corp.	USA	Battler	1400
1988	Nestle	Swiss	Diversified food prods.	Rowntree	UK	Chocolate confect.	3650

Apart from the mega-bids listed, well over 100 other major mergers have occurred in the sector valued at \$50m or more, between European firms, US firms and across both. A recent example of this level of restructuring is the takeover of Freshbake Foods (UK frozen foods) by Campbell Soup Co. (US) for £109m in 1988. The extent of the continued restructuring, rationalisation and Euro-bids from large US food companies, can only lend force to the view that their current dominant positions in many segments will only be reinforced by more open access to markets and further economies of scale.

The pace of acquisition pre-1992 suggests concerns to gain critical mass appropriate to the extension of markets beyond national boundaries. Simultaneously there is evidence of corporate restructuring as disposals have become noticeable in some large companies (e.g. Unilever, Fitch Lovell, ABF, Cadbury Schweppes). Appendix 3 highlights recent disposals. Management buy-outs are also increasing rapidly. Recent buy-outs in food manufacturing are listed in Appendix 4.

#### The Pressure Points for Change

EC companies are beginning to restructure to create units of sufficient size to compete with the major US and Swiss companies. While it is apparent that most parts of the EC

food industry, and especially the secondary processing sector, have recently undergone rapid structural development and increasing concentration, in all countries a wide range of firm and plant size continues to exist (Swinbank and Burns, 1984).

"Removing trade barriers is a necessary though insufficient condition ... for ensuring the continued competitiveness on a global scale of the EC food industry" (MAC, 1987)

The MAC Report (1987) argues strongly that the existence of trade barriers (especially non-tariff barriers) has served to protect relatively weak domestic food processing companies and, more importantly, has had the effect of encouraging strong companies to expand domestically rather than across European borders. Thus trade barriers have reinforced the relative fragmentation of the EC food industry compared to their major international rivals. The Economist Survey (1988) reached broadly the same conclusion, that although a reduction in the frictions of the European markets will make competition from non-European multinationals stiffer:

"...it may sap their relative advantage. They have, till now, been able to exploit big company efficiencies against fragmented competition in a fragmented Europe: that position of relative superiority will be undermined."

The comparison drawn by MAC is with the process of restructuring and rationalisation already observable in the world food industry, but more particularly with the precedent set by the pattern of consolidations in the US food industry. The US companies have been focusing on achieving nationwide brand dominance but with restricted product range. To this end they have been pruning their product portfolios and achieving both dominant market share, geographic coverage and hence higher profitability, in the selected product areas. The US food industry in the last five years has therefore been characterised not just by acquisitions in the related product areas, but also by mutual "swaps" of business units. EC food companies do not, as yet, follow a similarly EC-wide strategy. As the MAC data shows, they are relatively nationally (i.e. regionally in EC terms) focused.

The pressure for change, as well as the direction it should take, are therefore clear. Product portfolios, brand strengths and range of geographic coverage need to be reviewed, not least to be able to match the cost structure and margins of the major US competitors. Although national differences in taste, culture, language and distribution

systems have all contributed to the relative fragmentation of the European food industry, trade barriers and governmental protectionism have tended to reinforce rather than modify their effect. Post-1992, it is those EC-based food companies able and willing to undertake such a restructuring that will be (arguably) in the strongest position to compete with their US and Swiss rivals. They start from a considerable disadvantage since non-EC-based companies currently control almost half the strong brand positions within major EC markets and control over 60% of total food industry equity (MAC, 1987).

What is being advocated here is a simple reassessment in terms of the traditional Ansoff product/market matrix in response to a changed competitive environment. Traditionally, for the reasons mentioned above, EC food companies have tended to diversify into new product areas within their domestic market, rather than extending their existing (or new growth) product sectors into a larger number of EC markets.

One interesting aspect of this strategy is that it does avoid the mistakes made in the international restructuring following the deregulation of the financial services industry, where even the biggest and best-capitalised banks and securities houses failed to become international financial supermarkets. The lesson learned seems to support the recommended strategy of international specialisation in selected product areas.

A major assumption underpinning this strategy is the existence of European-wide market segments susceptible to international branding. The logic behind restructuring is the establishment of dominant brands in international market segments. The thinking behind "swaps" and related acquisitions is the creation of specialised brand portfolios in selected product ranges. The process has already begun with food processing capacity being concentrated in the hands of fewer, more efficient firms.

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Table 3 Top Food Companies in Europe

		Market Capitalisation - Mid May 1988
1.	Unilever Plc/NV (UK/Netn)	£3574.2 m
2.	Nestle (Swi)	SFr18 bn
3.	BSN Group (Fra)	FFr22.1 bn
4.	Jacobs Suchard (Swi)	SFr301 m
5.	Cadbury Schweppes (UK)	£1959.1 m
6.	Rowntree (UK)	£1896.5 m
7.	Associated British Foods (UK)	£1256.4 m
8.	Hillsdown Holdings (UK)	£1135.3 m
9.	United Biscuits (UK)	£1118.8 m
10.	Rank Hovis McDougall (UK)	£1042.0 m
11.	Unigate (UK)	£684.3 m
12.	Northern Foods (UK)	£660.3 m
13.	Dalgety (UK)	£653.8 m
14.	Tate & Lyle (UK)	£582.8 m
15.	S & W Berisford (UK)	£569.5 m
16.	Saint Louis Group (Fra)	FFr5.7 bn
17.	Perrier, Source (Fra)	FFr5.4 bn
18.	Booker (UK)	£502.3 m
19.	Beghin - SA (Fra)	FFr4.5 bn
20.	Hazlewood Foods (UK)	£426.2 m
21.	Bongrain (Fra)	FFr3.5 bn
22.	Wessanen (Neth)	Dfl1 bn

NOTE: Companies that have 70% or more of their equity held by one other concern, or that have only a minimal proportion of their capital openly traded on the stock market are excluded.



## Recent UK Acquisitions by UK Companies

Buyer	Price	Acquired	Market
Alma Holdings	£2.3m	Squirrel Horn (Confec)	Confec
Appletree	N/A	Hunters	Miscel
Appletree	N/A	Philips Ltd	F. Distb
A.G.Barr	£21.5m	Mandora St.Clements	Soft Drink
Barker & Dobson	£500,000	Chix	Confec
Barker & Dobson	£2m	Thousands Sweet Co.	Confec
J. Bibby	£10m	Inghams, Nitrovit, Wyatt Bruce	Animal Feed
Booker	£1.75m	Atlantic Sea Products	Fish
Booker	£5.5m	Nature's Best	Retail
Booker	£2.8m	Losley Dairy Products	Milk
Brake Bros.	£2.5m	Scotia Frozen Foods	F. Distb.
Carrs Milling	£0.15m	Dickensian Coffee Houses	Miscel
Cliffords Dairies	£3.75m	Roys Cooked Meats	Meat
Dalgety	£4.4m	Goldenlay Eggs	Eggs
Dalgety	£1m	Continental Savouries	Meat
Dalgety	£1m	C.S. Holdings	General
A. Fisher	£5m	S.P.I.	Wholesaler
Fitch Lovell	£2.13m	Freebooter	Fish
Fitch Lovell	N/A	Pullman	F.Distb
Freshbake	£624,800	Wright Ltd.	General
Freshbake	£1.8m	Betterbake Ltd.	General
Freshbake	£1.4m	Speciality Seafoods	F.Distb
Freshbake	N/A	Premier Vegetables	F & V
Geest	£10.2m	Clipper Group	Fish
Glass Glover	£3.1m	Emmet (Windsor)	Horticulture
Grand Met.	£12m	Fleur De Lys	Baking

Source: IQD

## Recent UK Acquisitions by UK Companies

Buyer	Value	Acquired	Market
Grand Met.	£19.5m	Dairy Produce Packers	Milk
Grand Met.	N/A	Roberts & Cooper	Retail
Grand Met.	N/A	Saccone & Speed	Retail
Grand Met.	£2m	S. Reece Ltd.	General
Grand Met.	£9.01m	MacCormick Products/ Connacht Foods	Milk
Hazlewood Foods	£1.326m	Cadec	Miscel
Hazlewood Foods	£7.4m	M.A. Craven	Confec
Hillsdown	N/A	Rowe, Munchett & Till	F & V
Hillsdown	£80m	Mallinson - Denny	Timber
Hillsdown	£6.5m	Firstan	Packaging
Hillsdown	£1.326m	Peter Hand Hldgs.	Animal Feed
Hillsdown	£3.4m	Tiverton Poultry	Poultry
Hillsdown	£1m	J.J. Yates	Insurance
Hillsdown	N/A	Inghams Stockfeed	Animal Feed
Hillsdown	£14.3m	Sleepeeze	Furniture
Hillsdown	N/A	Wyatt & Bruce	Animal Feed
Hillsdown	£40m	Fairview New Homes	Property
Hughes Food	£1.25m	Laurel Farm	General
Hughes Food	£354,200	Ivy House Farm	General
Hughes Food	N/A	S & A Foods	Meat
Hughes Food	N/A	A.T. Marshall	Machinery
Hughes Food	N/A	C.Anderson	Fish
Hughes Food	£550,000	R.E. Hatfield	Construction
Hughes Food	£350,000	Schooner Seafoods	Fish
Hughes Food	£2.76m	Peterhead Ice Co.	Fish
Hughes Food	£5m	Glenrose Fish Merchant	Fish
Hughes Food	£524,276	Icelandic Seafoods	Fish

Source: IGD

## Recent UK Acquisitions by UK Companies

Buyer	Price	Acquired	Market
Hughes Food	£100,000	Country Produce	General
Hunter Saphir	£6.3m	House of Clarks	Confec
J.L. Israel	£5.6m	John Martin Foods	Fish
John J. Lees	£700,000	Fullers	Confec
Northern Foods	£7.5m	Mattessons Walls (Factory)	Miscel
Northumbrian F.F.	£183,000	Shildon	Miscel
Northumbrian F.F.	£1.5m	Prewetts	Biscuits
Northumbrian F.F.	£1m	Sunwheel Foods	Biscuits
Park Foods	£242,000	Shaklee (UK)	General
Park Foods	£1.85m	Everfresh	Frozen
Paul's Malt	£15m	Associated British Maltsters	Malting
Perrier (UK)	N/A	Buxton Mineral Water	Soft Drink
Premier Brands	£15m	Glengettie Tea Co.	Miscel
Premier Brands	£2m	British Fish Cannery	Fish
Premier Brands	£20.2	Newtime Foods	General
Premier Brands	£8m	Ridgeways	Tea
R.H.M.	£282m	Avana	General
Rowntree	£5.2m	Richoux	Restaurants
C. Salvesen	£1.43m	Stowtime	F. Distb
Squirrel Horn	£450,000	G.A. Stadler	Confec
E.T. Sutherland	£780,000	St. Martin Foods	General
E.T. Sutherland	£17.5m	Home Farm Products	General
Unigate	£25.86m	H.A. Job	Milk
Unigate	£2m	B & A Britton	Miscel
34 Companies	£719.4m	78 Companies	

Source: IQD

## Foreign Acquisition by UK Companies

Buyer	Value	Acquired	Market	Country
Appletree	£17.9m	Kildare Chilling + Meats	Meat	Eire
J. Bibby	£21.4m	Nelles Griot	Optics	USA
Bio Isolates	N/A	Le Sueur Isolates	Milk	France
Cadbury	£95m	Chocolat Poulain	Confec	France
Cadbury	£3m	Red Cheek	S.Drink	USA
Cadbury	£9.84m	Taylor Foods	S.Drink	USA
Dalgety	£17m	Preservenbedrijf	Miscel	Holland
Dalgety	£3.7m	Mor - Green	F&V	USA
A. Fisher	£1.8m	Scalisi Produce	F&V	USA
A. Fisher	£15.4m	Lee Ray Tarantino	F&V	USA
A. Fisher	£4.194m	Reingold BV	F&V	Holland
A. Fisher	£28.8m	Citronas	F.Distb	Holland
A. Fisher	£10.8m	Movsovitz	F.Distb	USA
A. Fisher	£3.45m	Pacific Produce	F.Distb	Canada
Freshbake	£787,000	East Cork Foods	F&V	Eire
Grand Met.	£16m	Jim Dandy	Miscel	USA
Grand Met.	£791m	Heublein	Spirits	USA
Hazlewood Foods	£774,527	Associated Biscuits	Bread	W. Germany
Hazlewood Foods	£4.18m	Fri D'or	Frozen	Holland
Hazlewood Foods	£4.67m	Wafel Janssen	Miscel	Holland
Hazlewood Foods	£4.7m	Evers	General	Holland
Hazlewood Foods	£9.25m	HBB	General	Holland

Source: IGD

## Foreign Acquisition by UK Companies

Buyer	Value	Acquired	Market	Country
Hillsdown	£169m	Maple Leaf	Bread	Canada
Hillsdown	N/A	B&F Produce	F&V	Holland
Hillsdown	N/A	Blades Group	Fish	Canada
Northumbrian F.F	£750,000	Fibersund	General	Denmark
R.H.M.	£15.9m	National Preserve Co.	Miscel	USA
Rowntree	N/A	Norgen Vaaz	Confec	Australia
Rowntree	N/A	Candice Martial	Confec	France
Rowntree	£4.8m	Gorant Candies	Confec	USA
C. Salvesen	N/A	Agro GMBH	F. Distb	W. Germany
C. Salvesen	£1.9m	Mobileair	Freezer Equipment	USA
C. Salvesen	£13.4m	Langnese Iglo	F. Distb	W. Germany
C. Salvesen	N/A	Deges	F. Distb	W. Germany
C. Salvesen	£459,375	Pierce Industrial Air	Machinery	USA
Unilever	N/A	Celestial Seasoning	Miscel	USA
Unilever	N/A	Industries Revilla	Meat	Spain
Unilever	£2094.6m	Cheesborough Ponds	Toiletries	USA
Unilever	£81.2m	Bushells Hldgs	Wholsale Distb.	Australia
14 Companies	£3445.65m	39 Companies		

Source: IGD

## Divestments of Selected Companies 1986/1987

Disposed Business	Activity	Location	Approx. Consideration
<b>Cadbury Schweppes</b>			
Beverage & Food Divn.	Groceries	UK	£97m
Cadbury Slotts (75%)	Confectionery	Sweden	£4.5m
Oasis Industries (40%)	Bottler	New Zealand	\$26m
	Confectionery	Canada	C\$47m
<b>Fitch Lovell</b>			
Machin & Kingsley	Building & Materials Distributor	UK	£0.65m
Joseph Stocks Divn.	Traditional & Whole-Sale Bacon Operation	UK	£3m
<b>Northern Foods</b>			
Northern Dairies - Hereford/Folkestone	Liquid milk	UK	£6m
Tates	Supermarkets	UK	£3.7m
Goldrei Foucard & Son and Turner Bros.	Bakers Sundries Cakes Mixes & Ingredients	UK	£11.1m
Keystone Equity Group	McDonalds Meat Products & Distribution	USA	US \$66m
<b>Unilever</b>			
Thames Case	Corrugated solid cases & Boxes	UK	N/A
Three Oil Mills	Oil Milling	Neth. & Germany	N/A
Europower Hydraulics & EH Fluid Connectors	Engineering	UK	£3.1m
Massey International Coachbuilders	Vehicle Body Manufacture	UK	N/A
Research International Group	Market Research	UK	N/A
Thamesboard	Paper/Packaging	UK	£80m
Stauffer	Chemicals	USA	£16m

SOURCE: IGD.

## Recent Management Buyouts in the Food Sector.

Name of Company	Seller	Price	Activity
Jeyes	Cadbury Schweppes	£19m	Hygiene
Premier Brands	Cadbury Schweppes	£97m	Food & Beverages
Southern Belle	Northern Foods	C. \$5m	Meat (USA)
Mosspack	J.E.England & Sons	£27,000	Potatoes
Furniss of Cornwall	Argyll Group	N/A	Biscuits
Gold Crown Foods	Argyll Group	N/A	Coffee
K & K Greeff	Dalgety	£8.2m	Chemicals
Balfour Guthrie	Dalgety	£75m	Lumber (Canada)
John Perkins Meat	Management Buy-in	N/A	Meat Processing
Associated Fresh Foods - Dairy Divn.	ASDA	£65m	Dairy

Source : IGD Research

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