INDUSTRY NEWS

Consumer Focus

by *Jeff Taylor*

Super-premium foods

A growing taste for luxury fare is reshaping the food industry, and the trend is good for producers, especially since many of the extravagant morsels seem to be recession-proof. What does it take to go super-premium?

Developing the premium market

In the late 1980s, faster than you could say "Ben & Jerry's," Americans embarked on a love affair with decadent food, and their passion shows no sign of fading.

Margins for food producers were being squeezed like a lemon between the consolidation of the retail sector and the newly powerful buyers for those retailers pushing for lower prices. Multinational competitors had become so big that, through economies of scale, they were producing more food more cheaply than ever, forcing prices down even more.

Because food had become so abundant and cheap, consumers' mind-sets also began to change. "How could our food be better than ordinary?" they asked their grocers. "How can we get restaurant quality at home?"

Consumers had more disposable income than ever, and they had already demonstrated a willingness to pay more for quality in other industries such as the newly created luxury brands of automobiles, Acura and Lexus, and in the mainstreaming of the once unique, opulent Mercedes and BMW.

Häagen-Dazs and Ben & Jerry's demonstrated the automakers' success could be duplicated in the food industry, when a multitude of consumers began to enjoy high-quality ice cream, packaged in cartons half the size and twice the price of competing brands. Starbucks confirmed the possibilities by convincing coffee drinkers to switch from 50¢ black coffee to $3 cups with exotic names.

Super-premium products captured an ever-expanding share of the total category through the late 1980s and 1990s, but skeptics pointed to obvious risks. Could they maintain that success when the economy took a downturn? Was consumer demand large enough to sustain a full-scale business?

Economists like to believe that consumers are rational beings who, in uncertain economic times, shift to economy brands, causing premium product consumption to fall. However, the world is not that simple.

What economists fail to understand is that food-purchasing decisions are as emotional as they are logical. Even in lower-income areas, eating a super-premium product is a special event that temporarily enables the consumer to enjoy the same experience as others who are more fortunate.

During the modest downturns experienced in recent decades, the American consumer consistently showed premium food is an affordable luxury. During the recession of 1990-1991, overall ice cream sales slowed, but Häagen-Dazs' sales increased. Consumers were happy to make sacrifices so they could enjoy the occasional indulgence.

Producers of other categories quickly duplicated those early successes. After the development of pizzeria-like rising-crust pizzas, new products costing twice as much as standard frozen pizzas quickly displaced the more mainstream products. Soon, super-premium gourmet pizza lines followed — such as Wolfgang Puck and California Pizza Kitchen — enjoying great success as well.

Expensive, aged cheeses now appear on the shelves of mass merchants and club stores. Super-premium cuts of meat, such as filet mignon, are more available than ever. The market for costly organic foods is growing beyond most expectations.

The virtuous circle

Food falls into four basic categories — economy, value, premium and super-premium — based on its net price. The thresholds of each vary by food category, but a good rule of thumb is to compare a product's net price to that of the mainstream product, which usually represents more than 50% of the product category.

Value brands usually cost within 20%, either higher or lower, of the mainstream product. Economy brands generally cost less than 80% of the mainstream offering. Premium products tend to be from 20%-100% more expensive than the mainstream. Super-premium products cost more than double the mainstream product.

This is an important distinction, because the business model for super-premium food is fundamentally different from that of all other categories.

Mainstream food processors make a profit by producing large volumes of low-

CONTINUED ON PAGE 260

Entering the fourth dimension

A fundamental rule in the food industry is that the intrinsic growth rate is equal to the growth of the number of mouths to feed. The U.S. food market has been enhanced in recent decades by a combination of the obesity gap — the amount by which the food consumption growth exceeds population growth due to the excessive dietary consumption per capita — and the waste gap, the allowance for increased waste and losses in processing.

That aside, however, this fundamental rule set the baseline for food companies' strategic goals. So, how do food companies enhance their growth rates beyond that of the population?

The traditional approach to growth is to focus on the three dimensions of the food industry — product category, product type and customer channel — and capture more shares in one of those dimensions. A company may push a current product into a new channel, pull a new product into a current channel or design a new product type for a current product (e.g., turn a mix into a frozen ready-to-heat product). Increasingly, differentiation is being seen in a fourth dimension — quality.

CONTINUED FROM PAGE 258

margin products. Successful super-premium product lines, on the other hand, currently find themselves in the midst of a virtuous circle. Because volumes of super-premium foods are generally smaller, producers need a higher margin contribution per unit in order to make the same profit as a volume producer. Specialty processors use higher-quality raw materials to justify the higher consumer price.

The cost of these materials is a relatively smaller percentage of the total cost of the product, because the incremental cost increase is offset by an even larger price premium. At the same time, the production and the sales and marketing processes, once developed, are comparable in cost to the mainstream product. In other words, once the super-premium product or brand is established, processors have the opportunity to send strong profits to the bottom line. Successful super-premium products generally share a number of characteristics:

- The product can be developed such that it can be produced relatively efficiently;
- The consumer can identify the quality of the product as, indeed, super-premium;
- The particular super-premium category is large enough to support a certain threshold of scale and level of competition;
- The processor can maintain reasonable

raw material costs in order to capture the product's additional value in profit; and

- There are barriers to entry for competitors (super-premium products tend to have more unique characteristics) and lack of awareness to the opportunity.

More than ever before, people are willing to pay more to have a little of something that is really good, rather than a lot of something that is just average. Although there are no guarantees for companies that develop new super-premium products, consumers seem primed to respond. Whether coffee, bread, dairy, organic products or convenience foods, the opportunity in super-premium food products is compelling.

Editor's Note: *Jeff Taylor is vice president, investment banking, of Harris Nesbitt's Food Group, a firm providing capital, investment banking and financial services. This article is adapted from an article that originally appeared in the March 2003 issue of* Prepared Foods *magazine,* www.preparedfoods.com.

The "Consumer Focus" column features insights into consumer demand by addressing retail and restaurant trends, food science issues, and what consumers want, need and expect from the beef products they purchase. Beef nutrition, new products, food safety issues and more will be addressed.