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VERTICAL INTEGRATION IN THE FOOD INDUSTRIES

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My brief remarks will relate to vertical integration, by which I mean the performance of successive production and marketing functions within a single firm. I will not be discussing vertical coordination, which is an entirely different thing involving the relationships between firms at successive levels in an unintegrated system.

Below are listed some of the main kinds of vertical integration found in the food industries, the reasons for them and what seems to me their economic significance.

VERTICAL INTEGRATION BY FOOD MANUFACTURERS

The brand franchise, or pre-selling the consumer.

Many might not regard this as vertical integration, but it is - and a very important form of it. It is what the national brand companies are doing when they seek to pre-sell consumers on their particular brands by means of advertising, merchandising and sales promotion. It is a double-edged sword in today's marketplace: to the extent that consumers come to prefer a certain brand, the retailer of course accords it space on his shelves—and space on the supermarket shelf is hard to come by these days.

To measure how successful the national brand companies are in this form of vertical integration, take a stroll down a supermarket aisle; for most products you will find only a couple of national brands and the chain store private brand. Probably nothing has been more responsible over the past 50 years for the demise of the smaller food manufacturers than this form of vertical integration.

Integration of the wholesale distribution and selling function.

All large food manufacturers usually provide wholesale warehouse facilities for their products, many operate their own transportation equipment, and most employ their own salesmen rather than brokers and independent distributors. This kind of vertical integration can of course be done only by large firms having a "family" of products to bear the costs and utilize the facilities provided by such integration. Here is to be found one of the main reasons why producer cooperatives are unable to carry their products very far toward the consumer—with a few notable exceptions.

Self-manufacture of supplies and raw materials.

Most large food and beverage companies manufacture some of the supplies and raw materials they use - such as metal cans, glass and caps, cartons, wrappers, labels, etc. Some also engage in the manufacture of their basic raw materials. Kraftco, the largest user of edible oils, owns and operates an edible oil refining company. Usually these self-make operations are very advantageous to companies large enough to engage in them.

Frequently companies are led into these vertically-integrated supply functions because they are unable to obtain from outside suppliers the volume discounts to which they think they are entitled—sometimes because of oligopolistic pricing by the supply industries, and not infrequently because of Robinson-Patman type legislation. In such situations, vertical integration into self-make operations provides an additional competitive element.

VERTICAL INTEGRATION BY THE CHAINS

Virtually all the grocery chains - both the corporates and the cooperatives and even some of the smaller systems - have integrated backward from the retail unit. It is this vertical integration by the chains which provides a competitive alternative channel to the big food manufacturers, and in the food field the public needs both channels.

The integration of retailing and wholesaling. When the chains first appeared on the scene 50 years ago, they integrated the wholesaling function for their stores. It was a major break-through in food distribution that today is universal. Both the corporates and the cooperatives have integrated these functions, leaving unaffiliated, independent grocers an insignificant factor in food retailing.

The chain store private brands. All chain systems of any size, cooperative as well as corporate, have their private brands, the reasons for which are familiar to all of you. Some products sold under these private brands are manufactured by the chains themselves (especially in the case of the larger corporates), but much of it is bought from food manufacturers and producer co-ops. Nearly all sizable chain systems have integrated into the simpler food manufacturing fields—bread baking, coffee roasting, fluid milk and ice cream, and some have gone into more complicated areas such as meat packing, vegetable canning, poultry processing, the manufacture of preserves, salad dressing, etc.

Where the chains do not themselves manufacture for their private brands, they buy from various souces, and here are some interesting aspects. Some of the national brand companies still manufacture private brand merchandise for the chains, but increasingly they are discontinuing the practice. The usual sources for the chains are independent food manufacturers and, to an increasing extent, the producer co-ops. In many respects the operations of the chains and the co-ops tend to complement each other. For reasons already mentioned, the co-ops have difficulty carrying their limited product line forward toward the retailer, and the chains may have neither the capital nor the desire to engage in extensive food manufacturing operations, so there's a good basis for their dealing with each other.

INTEGRATION INTO FARMING BY THE LARGE FOOD CORPORATIONS

So far neither the large food manufacturers nor the big chains have integrated very far into farming itself, though there are some notable instances where they have - orange groves in Florida by Coco-Cola, beef feeding operations by some of the packers, poultry and egg operations by a few of the chains and the big feed companies, lettuce by Litton (or was it United Brands). Somehow I do not personally expect any major break-through by the large food companies into farming itself, at least not in the immediate future. This of course does not preclude a continuing trend toward large-scale corporate agriculture, but I would expect it to be mainly by corporations whose main enterprise is agriculture, rather than by the vertical integration of the big food companies.

The big food companies probably will not go extensively into farming. First, agriculture is very capital-consuming—that is it usually takes far more capital to grow or produce a given quantity of farm products than to process and distribute that same quantity. So most food firms will prefer to put their capital elsewhere. Second, most agricultural products are produced under very competitive conditions with small profit margins. Big corporations usually put their capital where it can earn the highest possible rate-of-return-on-investment. Usually this favorable return comes from products with their brand name and not the commodity-type product.

Some agricultural economists believed food manufacturers might go actively into farming to assure themselves of adequate supplies to meet their precise specifications. I don't think this is much of a factor—usually they can obtain their food raw materials in the marketplace or by contractual relationships with growers without investing their own capital in agriculture.

Some food manufacturers have been accused of going into agricultural operations in order to influence prices of raw farm products. The operation of feedlots by some of the meat packers is a case in point. I don't think this would be a major factor affecting the entrance of food corporations into farming.

SOME GENERALIZATIONS ABOUT VERTICAL INTEGRATION IN THE FOOD INDUSTRIES

Vertical integration in the food industries is a mixed bag. The various forms have developed for a variety of reasons, leaving elements both good and bad.

Only large, diversified companies can reap for themselves the maximum benefits from vertical integration. This is one of the major factors making for greater and greater enterprise scale during the 20th century. To some extent small enterprisers such as farmers and retailers can obtain for themselves some of the benefits of vertical integration thru their cooperatives, but they are handicapped by lack of capital and a "family" of products and enterprises within the firm.

Vertical integration in and of itself is not a direct monopolistic element, since it involves the *vertical movement* rather than the *horizontal control* of supply. To the extent that a vertically-integrated firm is operating in competitive markets, I think it is usually in the public interest because it results in savings and improved efficiency which can be passed on to the public. Only in the sense that vertical integration gives large firms an advantage over small ones, and is thereby a factor leading to horizontal monopoly can it be said to be inimical to the preservation of competition. In situations of this latter kind, I should think proper public policy should limit market share in the monopolized sector, rather than proscribing vertical integration as an evil in itself.