

Study
February 2021

Food and Beverage Industry Outlook

How changes in the economy affect Canadian
food and beverage manufacturers



Industry at a glance

\$118 billion

of sales of manufactured food and beverages (2019)



290,000
employed in food
and beverage
manufacturing

7,800

food and beverage processing businesses, 91% with less than 100 employees



25% growth in
exports over the
last five years

Why it matters

Agri-food processing is the second largest manufacturing industry in Canada, accounting for 17% of total manufacturing sales. The processing industry is an essential part of the Canadian food supply chain. It purchases about 40% of Canadian agricultural production and sells over 70% of its output to Canadian retailers and food service providers. This industry still has strong growth potential, especially at a time when we are looking to diversify and strengthen our economy in a downturn. With the world's population projected to rise to 10 billion by 2050, there are huge opportunities for our manufacturers to supply the growing global demand for food.

30%
of total manufacturing
sales is exported

70%
of food and beverage products
are bought by businesses and
consumers

Report highlights

Production disruptions, labour shortages, reduced demand from restaurants and new social distancing measures all hindered the industry in the early spring of 2020. At the same time, demand for food services shifted to retailers. Overall, the industry declined 5.2% to mid-2020 but had already recovered to pre-pandemic levels by the fall of 2020.

15.6%

growth expected in food and beverage manufacturing output over the next five years.



A shift to healthier, ethical and organic food products—Canada's food processors can remain competitive by quickly adapting to these emerging consumer preferences.



Exports of processed food and beverage products represent a third of the industry's output. The United States is the largest export market with 72% of sales.



Evolving consumer demand, labour shortages and the need to invest in new smart manufacturing technology will present both challenges and opportunities to businesses operating in this sector.

The food and beverage industry

Food and beverage manufacturers transform inputs into value-added products, which are then distributed to food retailers, food service establishments and consumers. The largest food and beverage processing segment in Canada is meat processing, which accounts for 17% of the industry, followed by bakery (14%) and dairy (9%).

Regional composition of the agri-food processing sector

Food processing is the largest manufacturing industry in most provinces. Ontario and Quebec account for most of Canada's production with respectively 42% and 24%.

Meat processing is the most significant food industry in Quebec, Ontario, Manitoba and Alberta. Grain and oilseed milling represents the most important sub-industry in Saskatchewan; beverage manufacturing is the largest sub-industry in British Columbia; and seafood product preparation is the most significant in the Atlantic provinces.

Exports of processed food and beverage products represent a third of the industry's output. Exports increased by 7% in 2019, compared to 2018. The United States is the largest export market (72%), followed by China (8%) and Japan (6%).



5 economic drivers to watch



Consumers shift to eat-at-home products

Consumer demand is shifting to grocery purchases and eat-at-home products.



Socio-economic factors

Population growth and rising incomes in Canada and around the world present huge opportunities for Canadian food manufacturers.



Commodity price volatility

Increasing input costs are an important challenge for processors.



Changing consumer preferences

Consumers are demanding healthier, higher quality, locally sourced and ethical products. Canada's food processors can remain competitive by quickly adapting to these changes in consumer preferences.



Automating production and adopting technology

Manufacturers need to integrate the latest technologies into their operations to boost productivity and take on the competition.



Consumers shift to eat-at-home products

The food and beverage industry is one of the few to have experienced a surge in demand as a direct result of the pandemic. Restrictions, including the closure of restaurants, resulted in consumers purchasing more groceries and even stockpiling them. Overall, food manufacturers saw sales increase by 1.8% between March and May 2020, while sales in the overall manufacturing sector declined by 27%.

78.9%

spike in grocery spending in March, 2020 over the previous year was triggered by consumers shifting to eat-at-home products and stockpiling food due to fears of shortages.

20%

higher grocery spending in November 2020 over the same month in 2019 indicates that consumers continue to spend more on groceries.

End of 2021

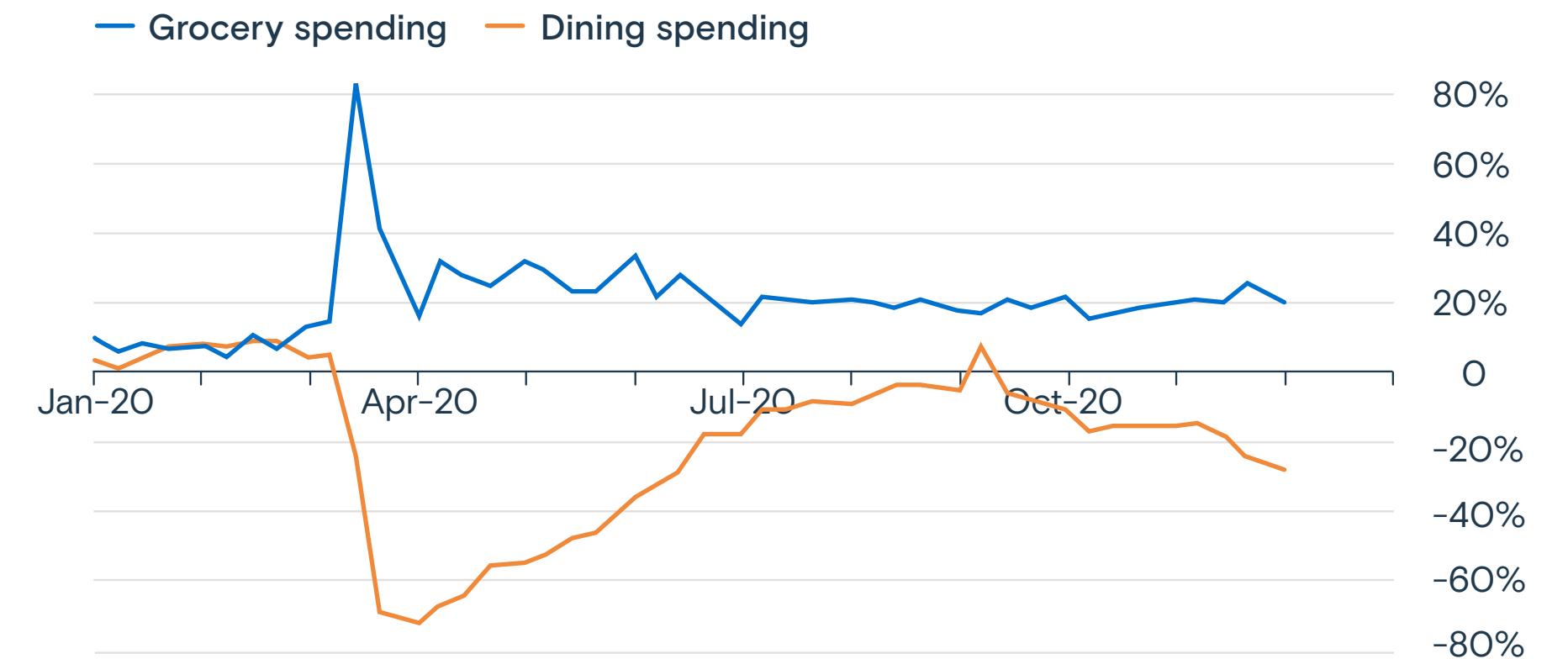
Even when restaurants reopen, restrictions will likely reduce their capacity for at least a few months. Therefore, higher demand for groceries will remain into 2021. It will then slowly subside towards the end of 2021, counterbalanced by increasing demand from restaurants.

Low demand from restaurants

and the hospitality sector continues as operator capacity is hindered by government imposed lockdowns, the absence of large events and reduced tourism. Demand for food manufacturers will be supported by consumers, who will continue to spend more in supermarkets in the near term.

Figure 1 : Grocery spending is still 20% higher than last year

Canada, year-over-year, % change



Source: RBC Economics, RBC Data and Analytics



Socio-economic factors

Population growth and rising incomes in Canada and around the world present huge opportunities for Canadian food manufacturers to position themselves as global leaders.

10 billion

Projected world population in 2050. In addition, a billion people will be added to the middle class and, as their incomes rise, they will spend more on food. Demand for meat and other sources of protein is expected to rise significantly in Asia and Africa.

40 million Canadians by 2025

Canada's population is expected to grow by 6.3% over the next five years.

14.5%

expected growth in disposable income in Canada by 2025.

Disposable income is forecast to rise at a faster pace over the next five years. Higher levels of disposable income will result in consumers increasing their spending on higher quality, higher quantities and a more diverse array of food products.

Increasing demand from international markets

will be a key driver of industry growth. Demand for protein is forecast to increase by as much as 70% by 2050. Canada has the potential to become the second largest agri-food exporter in the world after the United States. New initiatives such as Protein Industries Canada, a supercluster receiving federal government and matching industry investment, will help support this high-growth sector.

COVID-19 and disposable income

During a pandemic, economists would normally expect a sharp drop in household incomes. However, Canadian workers who lost their jobs during the COVID-19 pandemic saw their incomes sustained by the Canada Emergency Response Benefit and other government programs. As a result, disposable income increased by 11.8% in the second quarter of 2020, explaining, in part, the resilience of the food market.



Commodity price volatility

Poor weather, natural disasters, climate change, disease and trade disputes can all disrupt commodity prices. Higher agricultural commodity and energy prices are reflected in many inputs used by food and beverage processors, including ingredients, packaging, production costs and transportation. Ingredient supplies, in particular, are vulnerable to price fluctuations and are a major factor in business profitability.

65%

of food processors' expenses, on average, come from raw ingredients and inputs.

The Farm Product Price Index (FPPI)

measures price changes for raw agricultural products purchased by food manufacturers in Canada. The FPPI index rose sharply during the 2011-12 period, driven by a 25% increase in crop prices. In 2014, potato prices jumped by 15% and cattle and hog prices increased 18%. In the last two years, volatility came mainly from meat and vegetable prices.

A narrowing gap

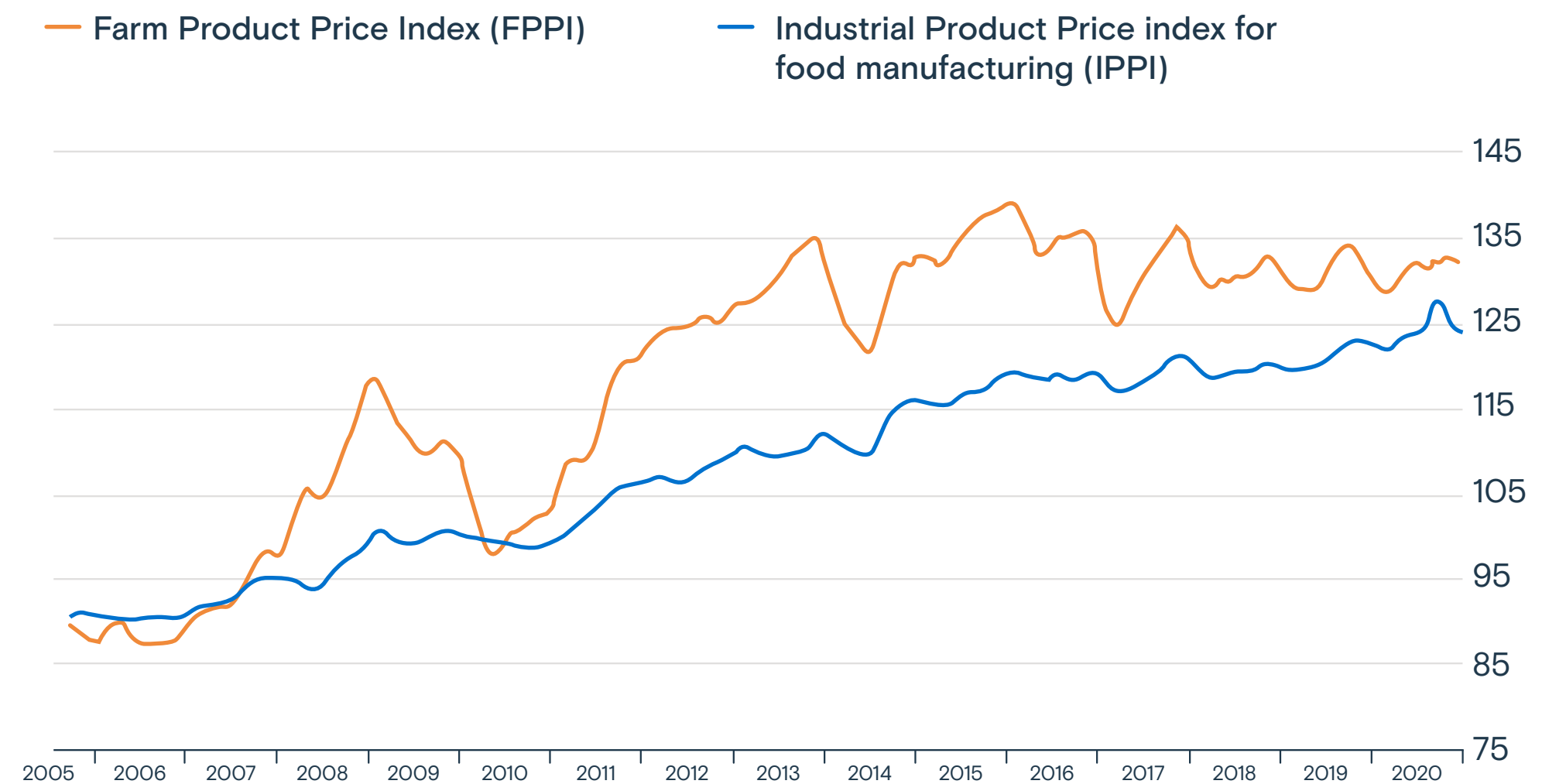
between selling prices for food processors, as reflected in the Industrial Product Price Index (IPPI), and ingredient costs over the last year has been positive for the industry. Yet, elevated uncertainty in the global economy could lead to heightened volatility in commodity prices going forward.

Innovative strategy

Traditional responses to increases in ingredient prices have been to substitute ingredients, operate on thinner profit margins and/or pass price increases on to consumers. Manufacturers can adopt more innovative strategies to mitigate commodity price volatility through such moves as focusing on higher value-added products, vertical integration and diversifying their product offerings.

Figure 2: Gap narrows between selling prices and ingredient costs

Canada, 3-months moving average, Index 2007=100



Source: Statistics Canada



Changing consumer preferences

Canadian food and beverage processors can no longer afford to compete on price alone. Growing numbers of consumers are demanding higher quality, locally sourced and ethical products. This has prompted many manufacturers to develop healthier versions of existing products and launch new products. Companies that fail to adapt to these pressures may lose out to more nimble competitors.

27%

of consumers are health conscious in Canada. Additionally, three in four Canadians try to eat healthy.¹

Higher quality and natural food products

Changing consumer preferences are boosting demand for healthy and organic products, including food free from artificial ingredients and additives, alternative protein sources, leaner meats, and low sugar and fat products.

Ethical consumers

are another influential segment, demanding safe and sustainable products. There is increasing pressure on manufacturers to reduce waste in their operations, including through progressive ingredient sourcing strategies and innovative packaging. Ethical products are even more important for those under 35 years of age.

1. Attitudes Toward Healthy Eating 2017 study

Buy local movement

drives Canadian consumers and food processors to source locally produced ingredients when available. An estimated 21% of Canadians increased their consumption of local products since the beginning of the pandemic, and 74% say they want to buy even more local products.

Transparency

is important to consumers. They now want to know more about the food they eat, including how it was processed, where it came from and how it was grown.



Automating production and adopting technology

The industry is automating and making better use of technology and data. Investments in these areas by Canadian food and beverage processors can drive major productivity gains. While, overall business investment is forecast to take around two years to return to pre-crisis levels, investment by food processors should rebound faster. This will be driven by a need to increase productivity and a favourable outlook for the industry.

\$3.2 billion capital investment

in machinery and equipment in 2019. More food processors are investing in new equipment to further automate production.

86%

growth in investment in the last five years, with particularly large increases in 2018 and 2019. In comparison, the overall manufacturing sector's investment grew by only 23% over the same period.

49%

of firms in the food processing industry invested in advanced technologies in 2017.

Labour shortages, high wage inflation and strict social distancing protocols

have hurt production and profits. To remain competitive, many operators will have to invest in technology to automate aspects of their production processes and decrease labour costs.

Lagging in tech adoption

While the industry has seen increasing investment in recent years, Canada's food processors still have low rates of technology adoption compared to other countries. Companies that fail to embrace automation, digitization and other technological advances will become increasingly less competitive.

What is the outlook for the food and beverage sector?

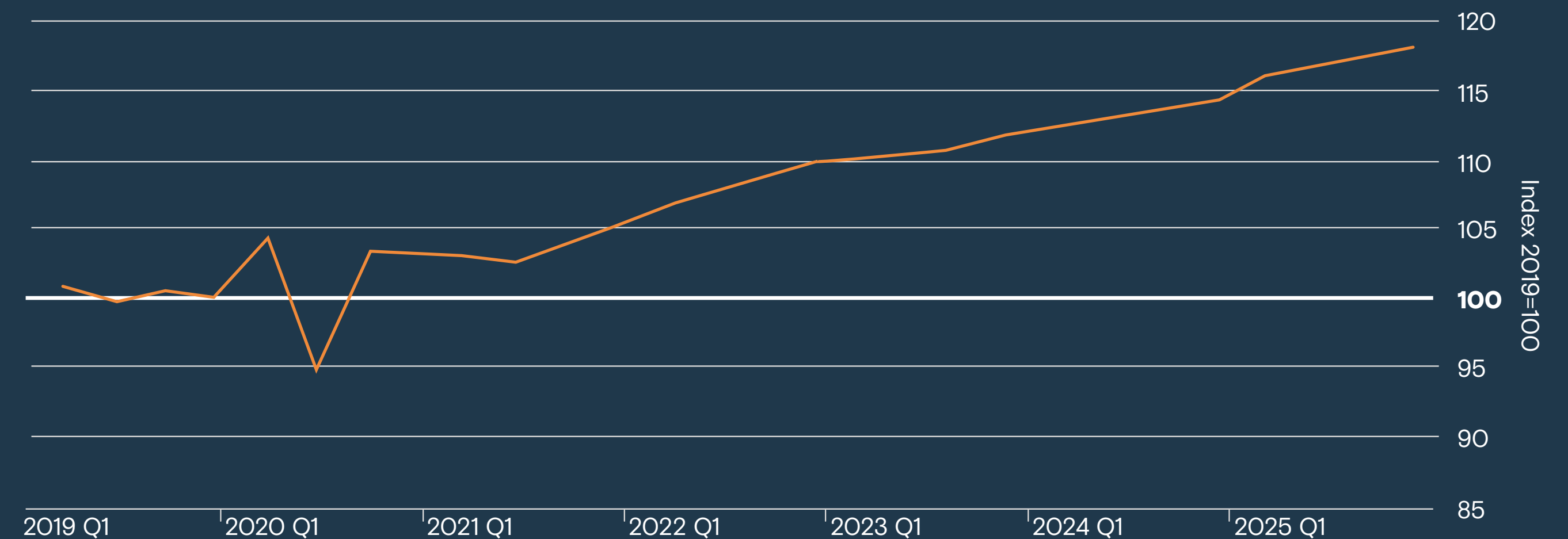
Strong growth over the next 5 years

While the pandemic caused a 5.2% output decline to mid-2020, it had already recovered to pre-pandemic levels by the fall of 2020. We estimate the food and beverage manufacturing industry experienced overall growth of 1% in 2020. The industry is expected to grow by 2.4% in 2021 and gain a further 4.5% in 2022. Compared to its pre-crisis level, gross output is expected to grow by a cumulative 15.6% by 2025.

Our baseline scenario assumes that the overall economy will return to its pre-crisis GDP only by mid-2022.

Figure 3 : Food and beverage manufacturing output in Canada

Quarterly, seasonally adjusted at annualized rate, Index 2019=100



Sources : Oxford Economics, BDC Economics.

Taking advantage of post-crisis trends

Evolving food demand, labour shortages as well as a need to keep investing in new technology will present both challenges and opportunities for businesses operating in this sector.

Export diversification

Challenge

The concentration of food exports in terms of products and trade partners is a trade risk to be monitored in an era of rising protectionism and commodity price volatility.

Opportunity

A goal for the industry is to diversify its products and trade partners away from the U.S.. Firms should orient their diversification strategy toward the rising middle class in developing countries, which is creating new export opportunities. Much of the future growth will come from there.

Evolving food demand

Challenge

A growing middle class around the world is demanding higher quality products, while socially conscious consumers want locally sourced and sustainable food.

Opportunity

Market research and product development can help companies determine customer needs and what products will meet them. Companies that embrace new trends and innovative products will position themselves as preferred suppliers.

Tight labour markets and evolving skill requirements

Challenge

Canadian food processors face labour shortages. These shortages will intensify as markets for Canadian products expand. Moreover, the skill sets required for the sector are evolving.

Opportunity

To compete, companies will need to invest in automation and digital logistics systems, as well as in training employees to work in increasingly high-tech facilities.

Rethinking manufacturing processes

Challenge

Managing resources and processes represents a major challenge—one-third of global food production is lost in the supply chain. Unexpected contingencies demand flexible provisioning and adequate inventory management systems, while varying temperature and humidity conditions require safeguarding supply chains.

Opportunity

Smart manufacturing has the potential to drastically change the way processors perform their operations. Optimization tools, precision scheduling and analytics allow companies to maximize capacity and uptime; adapt to customer needs in real time; reduce ingredient and food waste; and reduce costs.



How food companies can beat the competition

Re-evaluate your distribution strategy

With many consumers now working at home, it's important to review your distribution strategy to make sure your products are where your customers are.

Focus on digital marketing

The growth of online grocery shopping means food processors have to improve their digital marketing game or risk being left behind.

Think positioning first when developing new products

Many food companies don't give enough thought to what consumers want in terms of new products, including pricing, before diving into developing tasty new offerings.

Market research is key to exporting success

Exporting is tough. It requires a dedicated team and investment in research to understand consumer preferences and other dynamics in your target markets.

Methodology

BDC produced its forecasts using the Global Economic Model from Oxford Economics. It uses an error correction methodology, where multiple time series estimate the speed a dependent variable returns to its equilibrium after an exogenous shock. This large-scale macroeconomic model has the advantage of being comprehensive as it includes thousands of macroeconomic variables.

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