

Ready to eat breakfast cereal industry



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However, a change in consumer demand in 1994 has dented the sales growth of this classic oligopoly. This has been due to the continual proliferation of alternative breakfast options mainly from private labels. The negative 4% (around \$320m) disparity in market share needs to be plugged. The challenge now is to find out why they (RTE) have been such a profitable business and what changes have led to the current industry crises.

The RTE cartel have avoided head to head competition with each other and often adjusted their prices and advertising expenditure in line with each other. Such deliberation, albeit an unwritten tenet, offered all parties regular return of investments (ROI) of up to 30% for their cereal operations. The strategy being played also worked to block entry into their lucrative market.

It seemed strange that with such high earning potentials in Return on Investment (ROI), the industry was failing to attract substantial competitive entries in this market. More competitive entries in this market would have eliminated the stable nature of the market thereby forcing prices down. Many people, including consumers, believe the RTE were not competing fairly in all their operations. The OFT then acted. The effective monopoly of the market had to cease.

The RTE business has been profitable since its inception. Consumption has increased tremendously since their introduction over 100 years ago contributing to the brands successes. Although sales have slipped for cereal makers RTE cereal is still a favourite breakfast food. Profitability seems to have stemmed from the strategies employed especially those that contain the threat of new entries. The oligopolic market of RTE allowed the Big Three

to control 76.5% of it. This gave them a ROI for their cereals division up to 30% (approx. \$80m per percentage point) which was much higher than the food market they operated in. There is a twofold reason why RTE market has become a success. They maximised their profits and avoided price wars with one another. Also equally important is the creation of significant entry barriers.

The brand proliferation strategies which the three major players utilised offered a plethora of products /brands to cater for every profitable niche in the cereals market. There was less likelihood of new entrants as (a) most markets were satisfied (b) launching new products was high with little profits to plough back into production and promotion.

The RTE had intensive advertising and promotion expenditure. This was in excess \$315 million in 1993 and was designed to differentiate similar products and promote their trademarks. It also aided in brand recognition and loyalty. Such massive spending in itself added to the deterrence of new entrants as they would be forced to spend extra funds or else suffer a lengthened delay in becoming established in the market.

Private labels grew 50% between 1991 and 1994. They and gained over 9% market share. This was achieved by private labels positioning themselves alternatives to expensive cereals. They further offered better margins to grocers (3% more than the Big Three were offering) giving the grocers better returns and savings for the shoppers. The increase in market share allowed increase technological competence ensuring production of higher quality

cereals thereby garnering more market. The emergence of Discount stores also assisted in the proliferation of the substitute cereals in the market.

The current trend of price conscious consumers requires drastic action to win back the lost market share. The Private labels share was predicted to surpass 15% by 2000. It appears the private label threat was not considered a threat by the other two brand producers. The strategic reduction in prices and promotions was designed to win back the share lost to private labels. This decision to reduce its prices is risky could have had far reaching consequences if the other members did not follow suit as was the usual “unspoken agreement”. For a market that has abstained from profit erosion by price undercutting it was a first. Another factor worth noting is that competitors may take the action to represent the initiation of price war. If they further cut their price to undermine GM.

The Minimisation of trade promotions achieves an increase in profit as fewer overheads such as administrative costs, coupon printing costs etc. will be required. This coupled with reduction of prices should effectively increase their market share. General Mills’ decision to opt to spend the advertising budget on direct advertising is a wise move as it increases loyalty to their brand. The idea of this operation is to stress lower prices without damaging the brand.

GM’s competitors have two options. Either follow or do nothing. If they do nothing and keep existing pricing and advertising strategies they may gain GM share from consumers that GM’s reduced prices are not more beneficial

than the benefits they derived from the coupon discounts. Competitor action will be based on their understanding of how price sensitive their market is.

If the other brand manufacturers follow GM's lead and reduce their prices by 11% and likewise their spending on promotional activities, they would attract much of their lost market share and attract increased profits for each manufacturer.

GM, in my view, has done the right thing by addressing the source of decline – by thinking about their consumers first. The current conditions revealed the strategy they were maintaining wasn't conducive to sustainable growth. The steps they took to reduce the aggressive and costly coupon model may have compensated for some of their lost revenues.

It would be hoped that the reduction in price would have brought back some of their share lost to the private labels. Whilst it is true that the price differential between GM and the private label still suffer a disparity, it is viewed that this move would entice the return of those who were uncertain of which products to buy.