

State of the Industry: Retail Bakeries in the U.S.

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Drivers of Industry Growth

- The U.S. retail bakeries industry continued to grow at a solid rate in 2016. Improving economic conditions have led to an increase in consumer spending over the past few years, particularly for indulgent food and beverage products. Although the lingering effects of the economic recession are still prevalent, retail bakery sales grew by a robust 6.0% in 2016, with even stronger growth estimated for 2017. As the U.S. economy continues to strengthen in 2017, retail bakery sales will advance by an estimated 6.8%. In fact, several trends point to steady industry growth through 2021. Some of the key trends that will drive industry sales over the next few years include consumers growing infatuation with whole grains, fiber, protein, and other healthy ingredients such as nuts and seeds; the elimination of unhealthy trans fats; reduced sugar, sodium, and cholesterol bakery products; upscale and artisanal baked goods in smaller portions; more frequent and indulgent snack and meal occasions; the growing popularity of organic and natural bakery products that are free of GMOs (genetically modified organisms) and additives/preservatives; the move toward “greener” practices; growing transparency and traceability of ingredients; more convenient packaging; an increase in digital and traditional promotional activities; and an overall attraction to baked goods that is no longer excluded from popular diets.
- The emergence of gluten- and allergen-free bakery products will also boost sales over the next few years, along with new ethnic-inspired flavors and ingredients, especially from the Latin, Middle Eastern, Asian, and Mediterranean cultures. Unusual pairings of popular flavors, such as savory and sweet combinations, will provide excitement in the bakery industry, as well as limited edition and

seasonal flavors. Hybrid products, like the cronut (a croissant-doughnut pastry), crookie (a cookie-croissant), and duffin (a doughnut-muffin), will also spark consumer interest. Although specialty bakeries that focus on a single line of products will be in better position to provide innovative and customized baked goods, traditional retail bakeries are capitalizing on this trend by offering unique formats and flavors as well. Retail bakeries can also increase profits by partnering with local businesses, such as restaurants, to provide specialized product offerings unique to that establishment. In particular, cupcakes and small cakes, doughnuts, whole wheat/whole grain bread and roll products, artisan and European-style breads and flatbreads, and innovative cookies will be a few of the products that fuel retail bakery sales growth through 2021.

- Consumers' palates are changing and they are looking for bolder, more intense flavors. An overall trend toward upscale or gourmet foods is evident in many industries, including cheese, chocolate, coffee, wine, and beer. This is also affecting the bakery industry, particularly for artisan breads, doughnuts, cookies, cakes, cupcakes, and other sweet baked goods. Although the economic recession negatively affected consumers' spending habits during that period, many are still willing to pay more for an upscale baked good because it is seen as a value-added, high quality product that is an affordable luxury. One of the biggest upscale trends is healthfulness. To health-conscious consumers, no preservatives, ancient and whole grains, and all natural add value to a bakery product. Upscaling products with smaller portion sizes is proving to be very successful, as consumers become more concerned with wasting food and money. Smaller packaging sizes, products made for two people, half cakes and pies, and even individual cake slices are now prevalent in retail bakeries. While it seems odd to promote higher priced, upscale bakery products in the wake of a recession, health is a relatively economy-proof concern among consumers. An upscale, value-added baked good can also help create excitement and the feeling that consumers are getting an authentic product of high quality, further alleviating the worries of paying more.

- While overall food and beverage expenditures are rising steadily, the consumption of these products away from home passed the level of at home consumption in 2015 and continued to grow at a considerable rate in 2016. Americans seem to always be on-the-go. With dual income households becoming the norm, there is less time available to prepare meals at home. The shrinking availability of time, along with extra income, has led consumers to eat out or on-the-go more than ever before. The recession did cut the growth rate of food expenditures away from home in 2008 and 2009, but this was short-lived as expenditures have bounced back over the past few years and will continue to rise at a solid rate through 2021. Convenience, portability, and price will continue to be the most important factors in determining food choices away from home, in addition to quality and health benefits. Innovations in portion control packaging and expanding snack occasions will also affect food and beverage expenditures away from home.
- A few negative factors that will affect the retail bakeries industry through 2021 include volatile ingredient and energy prices, rising payroll and healthcare costs, competition from in-store bakeries and fast-casual restaurants, and the improving quality of packaged baked goods. Nonetheless, retail bakeries that offer fresh products with high quality ingredients, affordable pricing, a clean and uncluttered store, enticing display cases, short wait times, and excellent customer service will be most successful over the next few years. Consumers also want to know the story behind the bakery and production process and are willing to pay a premium for an original, higher quality product.

Health and Dieting Trends Reshape the Industry

- While whole grains are now prevalent in many baked foods, it has had the most impact on the bread market. After the decline of low carb diets, new bread products flooded the market with an emphasis on healthier whole grains. Consumers are now embracing whole grains and other healthy bakery products

as long-term components of better eating. Trans fat free products are also in high demand because of the health concerns regarding this type of fat. As the Food and Drug Administration (FDA) prepares to institute a ban on partially hydrogenated oils (PHOs), there will likely be more claims related to trans fat content in baked goods. Furthermore, calorie counts will be more prevalent thanks to a new law that requires restaurants with 20 or more units to publish calorie counts on menus.

- Now that manufacturers and retail bakers have successfully incorporated grains and more fiber in baked goods, many are experimenting with the inclusion of other healthy ingredients, such as Omega-3 and -6 fatty acids, protein, vitamins, minerals, prebiotics, and probiotics. Probiotics are live cultures that exist naturally in the digestive system and are useful for healthy digestive functions. Since 60 to 70 million Americans experience some type of digestive health issue, the market for baked goods with probiotics can be very lucrative. Meanwhile, prebiotics, which are nondigestible food ingredients that may beneficially affect the host by selectively stimulating the growth and/or the activity of a limited number of bacteria in the colon, will also be added to some bakery products in an effort to stand out in this competitive industry.
- Intense media coverage of the obesity epidemic has resulted in new dieting trends and a wave of health-conscious consumers. According to the Centers for Disease Control and Prevention and the United Health Foundation, 29.4% of adults (aged 20 years and over) were obese in 2014, up from 27.6% in the previous year. Meanwhile, more than 60% of adults were overweight or obese. Americans are not taking the news lightly, as the obesity rate actually dipped in 2013 before rising again in 2014. Improving economic conditions are resulting in more food consumption away from home, a possible reason for the uptick in the national obesity rate in 2014. Nonetheless, only Colorado and Hawaii had obesity rates under 22%, while eighteen states had obesity rates of more than 30%. West Virginia and Mississippi led all states with an obesity rate of 35.1% each. By region, the South had the highest prevalence of obesity (30.2%),

followed by the Midwest (30.1%), Northeast (26.5%), and West (24.9%) regions. Furthermore, childhood obesity continues to be a major problem in the U.S., as the childhood and adolescent obesity rate has more than tripled in the past two decades to approximately 17.0% in 2014. Perhaps a result of the obesity epidemic, more than 25 million people are also dealing with diabetes in the U.S.

- In 2016, nearly 30% of U.S. consumers were on some type of diet, while approximately 40% were trying to lose weight. The majority of dieters believe that whole grains are most important for their health and weight management, followed by high fiber, and ingredients that help the heart. Consumers are now shifting their choices to wellness and nutritionally enhanced foods. Consumers do not feel they have to cut out their favorite foods in order to lose weight. Many are taking a balanced approach to their diets and are focusing on their overall well being, not overanalyzing each item they eat. This has led to a rise in more indulgent, upscale food consumption, as consumers often treat themselves to more indulgent foods despite dieting trends.

Organic Bakery Product Sales

- A significant trend encompassing both healthy and better quality foods is the skyrocketing popularity of organic and natural foods and beverages. Organic and natural foods and beverages are becoming a part of the American mainstream, as they are being found in more and more retail outlets, as well as restaurants and other foodservice establishments. Not only do consumers prefer organic foods and beverages because they are free of agricultural chemicals and other unnatural elements, they also feel organics are more authentic and of better quality. This has been the case with organic bakery products, where organic and gourmet trends have come together.

- In 2016, total organic food and beverage sales in the U.S. grew by an estimated 10.5% to \$50.0 billion, following a 10.9% increase in the previous year, according to Sundale Research's "Organic Foods and Beverages" report. Prior to the last six years of double-digit growth, poor economic conditions, high unemployment rates, and slower consumer spending did not have an overwhelmingly negative impact on the organic foods and beverages industry, as sales grew at a moderate rate during this time, especially when compared to the overall food and beverage industry. While some consumers traded down to cheaper organic products, switched to private label brands, or temporarily eliminated organics from their budgets, many others did not change their buying habits or even increased their spending on organic foods and beverages. Nonetheless, as the U.S. economy continues to strengthen over the next few years, sales are expected to grow at an average annual rate of approximately 9.0% per year through 2021. Companies that offer locally sourced organic products from sustainable farm programs will be most successful.
- More specifically, sales of organic breads and grains grew by an estimated 8.4% to \$4.34 billion in 2016, while sales of organic snack foods advanced by an estimated 12.0% to \$2.45 billion. Sales for both categories are expected to grow significantly through 2021. Retail bakeries can set themselves apart by offering a variety of organic products, particularly those that are locally sourced from sustainable farms. According to industry research, sales of organic products through in-store bakeries reached \$325 million in 2016, while sales of organic foods in retail bakeries are estimated to be just under this amount. Although organic foods tend to have a higher price tag than non-organic products, the rising price of wheat and other ingredients for non-organic foods has closed the gap in price. Growing demand for organic wheat flour and other organic ingredients is leading to an increase in production, and ultimately, lower prices. In late 2015, for example, Ardent Mills launched an organic initiative committed to helping U.S. wheat growers double organic wheat acres by 2019.

Greener Practices Can Increase Profits and Sales

- The retail bakeries industry is making an effort to adopt environmentally responsible business practices. Consumer demand for green products is creating more awareness among bakery companies, as they may be able to attract more customers by reducing their carbon footprint. The rising cost to produce baked goods can also be offset by using environmentally friendly practices, not to mention the positive affect it will have on the planet's natural resources. The green movement is only expected to grow over the next several years, as consumers become more and more eco-conscious. If the exceptional growth in the natural and organic products industry is any indication, sales of environmentally-friendly baked goods will grow through 2021 and beyond.
- Many retail bakeries are implementing greener practices by using alternative sources of power and packaging materials, sourcing local and sustainable ingredients, and building structures based on standards set by the LEED (Leadership in Energy and Environmental Design) program of the U.S. Green Building Council (USGBC) and the Green Restaurant Association (GRA). In general, there are a few other key steps retail bakeries can make to achieve greener business practices. Some of the most important and feasible actions include increasing energy efficiency, conserving water, reducing packaging, using less paper, and sourcing sustainable ingredients. The overall strategy for becoming greener can start by simplifying day-to-day operations and assessing the impact of each step of the baking process. While only a modest percentage of consumers are willing to pay more for a green product, this figure is growing, particularly among Millennials (consumers 21 to 38 years old in 2016). When the price of green products is similar to that of conventional options, environmental concerns often provide the tiebreaker that leads consumers to go green.

Gluten- and Allergen-Free Products Boost Demand

- Sales of gluten-free bakery products are growing at a significant rate. Gluten-free diets contain no ingredients derived from gluten-containing cereals, such as oats, barley, rye, and wheat. Those who suffer from Celiac disease, for example, are limited to gluten-free foods, but many advocates believe that gluten negatively affects a larger demographic by contributing to many diseases. In addition to the increased awareness of Celiac disease, gluten intolerance, and gluten ataxia, improvements to the taste and texture of gluten-free foods is sparking demand. These improvements have also helped expand the diversity of gluten-free product offerings. Today, gluten-free baked goods encompass everything from brownies to coffeecakes to bagels. The fastest-growing gluten-free bakery categories include cookies, bread, rolls, cakes and cupcakes, and bagels.
- The number of Americans following a gluten-free diet has tripled over the past five years, while the diagnoses of celiac disease remained stable. Nearly 30% of consumers are now purchasing foods labeled as gluten-free, as consumers increasingly shift toward healthier lifestyles and believe gluten-free products are healthier. Sales of all gluten-free foods (excluding those that are naturally gluten-free) reached \$12.5 billion in 2016, increasing by an average of nearly 25.0% per year over the past five years. Sales are expected to grow at an average annual rate of about 14.0% per year through 2021, totaling \$24.0 billion at this time. The gluten-free food industry will be driven by clean and transparent labels, plant proteins, and ancient grains.
- Because the number of food allergy and intolerance sufferers in the U.S. ranges from 10 to 15 million people, the market for allergen-free foods is also booming. This, along with a 2006 law requiring labeling for allergens, has prompted some manufacturers to use allergen-free ingredients to set them apart from the industry. Many retailers are responding with dedicated grocery departments for gluten-free and other allergen-free foods. Gluten- and allergen-free foods allow

many consumers to lead a normal life and still enjoy their favorite foods. Consumers with food allergies are not the only ones seeking out allergen-free foods. Many others perceive these products as being of higher quality and better for them compared to conventional varieties, expanding the niche market for gluten- and allergen-free foods. As the quality of these foods continues to grow, so will the product offerings and overall market size.

- Other popular allergen-free baked goods include dairy-, nut-, soy-, and sugar-free (diabetes) varieties. The fastest-growing dairy-free bakery categories are cookies, bread, rolls, cakes and cupcakes, and pastries. Gluten- and allergen-free foods are found at more than 25% of full-line retail bakeries, while sugar-free foods are offered at approximately 30% of these establishments. Small to midsize companies typically have more flexibility and have been at the forefront of the gluten- and allergen-free movement, but larger diversified bakeries are listening to consumers' demands and are offering a targeted mix of gluten- and allergen-free options as well.

Bakery-Cafés Among Hottest Foodservice Segments

- Bakery-café concepts rank among the fastest growing segments of the foodservice industry. This concept combines traditional retail bakeries with coffee shops, creating a place where consumers can relax with their favorite baked goods and cup of coffee. It also caters to consumers who are on-the-go and do not have time to make more than one stop for everything they crave. People have developed a taste for upscale premium-priced coffee, tea, and baked goods, which has set the stage for remarkable sales growth among bakery-cafés. The atmosphere of coffeehouse culture is especially attractive for today's consumer. Many bakery-cafés have a welcoming presence with music, trendy décor, and Internet accessibility. These establishments have also expanded their product offerings to include sandwiches, soups, salads, and specialty beverages. The appeal of moderately priced, high quality products in a

fast-casual setting is contributing to bakery-café's success, as consumers continue to trade down from full-service establishments.

- As the economy strengthens over the next few years, both retail bakeries and coffee shops will experience strong sales growth. In 2016, coffee shop sales in the U.S. jumped by 7.6% to \$19.3 billion, while retail bakery sales grew by 6.0% to \$5.16 billion. Although there is no reliable bakery-café data available at this time, Sundale Research believes sales in this segment reached \$10.6 billion in 2016, a 7.1% increase from the previous year. Sales are expected to grow by an average of approximately 7.5% per year through 2021. Innovative products and flavors, varying portion sizes, the use of high quality and exotic ingredients, the strengthening of under-performing operating times and services, catering to a younger audience, and better franchising efforts will continue to drive demand for bakery-café's for the next several years. According to industry research, sales for the top 25 bakery-café chains reached \$8.0 billion in 2016. The top 12 chains include Panera Bread, Einstein Bros. Bagels, Au Bon Pain, Cusi, Corner Bakery Café, La Madeleine Country French Café, Frullati Café and Bakery, Lee's Sandwiches, The Kolache Factory, Boudin Bakery, Andersen Bakery, and Tartine Bakery & Cafe. In April 2017, Panera Bread announced that it will be acquired by Europe's JAB Holding Co. for more than \$7.0 billion. The transaction is expected to close in the third quarter of 2017.

Retail Bakery Sales Trends

- Retail bakery sales in the U.S. grew by 6.0% to \$5.16 billion in 2016, following a 7.6% boost in the previous year. Improving economic conditions have led to seven consecutive years of solid growth for retail bakery sales. During the 2010 to 2016 period, retail bakery sales advanced by an average of 6.6% per year. Prior to this, however, the industry was in a slump thanks to poor economic conditions, a rising unemployment rate, and slower consumer spending. The retail bakery industry, which had proven to be fairly recession-proof, could not

escape these negative factors in 2008 and especially 2009, as retail bakery sales declined in back-to-back years after a long period of growth. While consumers did not abandon bakery products altogether, many traded down to less expensive products or smaller varieties, looked further for sales and discounts, or purchased items less frequently. Nonetheless, the industry rebounded significantly over the past few years and is poised for steady growth through 2021, as the economy continues to strengthen, unemployment rates fall, and consumer confidence rises.

- In 2017, retail bakery sales are estimated to rise by 6.8% to \$5.52 billion. While better economic conditions and the drivers of industry growth discussed earlier will continue to fuel retail bakery sales over the next few years, there are a few negative factors that will affect retail bakeries, including the expansion of in-store bakeries (see "Competition from In-Store Bakeries"), volatile ingredient and energy prices, rising payroll and healthcare costs, and better quality packaged baked goods. Despite a few negatives, retail bakery sales in the U.S. are expected to increase by an average of 5.5% per year from 2016 to 2021, reaching \$6.74 billion in the latter year. As the industry grows larger and larger, it will become more difficult to keep up the same rate of growth achieved over the past several years, but there are no signs the industry is letting up anytime soon.

Product-by-Product Sales Analysis

- In 2016, sales of breads and rolls in retail bakeries grew by 5.2% to \$684.3 million. The end of strict low carb diets and a rise in the popularity of whole grains and artisan breads will continue to fuel the category's growth. Old World, European-style breads will also exhibit solid growth, including the popular Italian Ciabatta and Focaccia breads. Breads and rolls will be among the top-selling retail bakery products through 2021. Other trends in this segment will include strong demand for mini bread loaves and other bread products, such as

flatbreads, pitas, wraps, crusty hearth rolls, Panini bread, and slider-size buns. Pretzel bread and rolls will continue to be popular, as well as ethnic-inspired options such as traditional levain-based Russian, European dark rye breads, Middle Eastern Naan and Lavish breads, and egg-based breads such as Challah. From 2016 to 2021, bread and roll sales in retail bakeries are expected to increase by an average of 4.6% per year, totaling \$855.9 million in 2021.

- Cakes and cupcakes are also popular retail bakery items. In recent years, the popularity of more elaborate and indulgent cakes and cupcakes has risen dramatically. Cake and cupcake competitions and television shows have contributed to the category's success. Recently, smaller sized cakes and upscale cupcakes have been in high demand. In 2016, sales of cakes and cupcakes in retail bakeries jumped by 8.1% to \$532.0 million. Sales will continue to grow at a significant pace over the next few years, as it appears the cupcake craze is here to stay for a while. Overall, from 2016 to 2021, sales of cakes and cupcakes in retail bakeries are expected to increase by an average of 7.2% per year, totaling \$754.8 million in 2021. Sales will be driven by smaller sized cakes and creative and indulgent cupcakes in a variety of innovative and unique flavors. One example of the strength of the cupcake market is Sprinkles introduction of cupcake ATMs in March 2012. Sprinkles first launched a 24-hour automated cupcake machine in front of its flagship store in Beverly Hills, California. The machine operates with an iPhone-like interface and can hold 595 cupcakes. The cupcake ATM is generally restocked three times per day, and based on its popularity, Sprinkles will continue to open them across the U.S. In March 2014, the company opened a cupcake ATM in New York City, following launches in Los Angeles, Chicago, Atlanta, and Dallas.
- While cookies do not necessarily fit into current dieting trends, sales of certain types of cookies in retail bakeries remain strong. A trend toward more indulgent and innovative cookies, particularly those made with chocolate, fruit, and savory ingredients, are fueling the category's growth. Bakeries are also getting flavor inspirations from other dessert categories and launching limited edition and

seasonal varieties to create more excitement. Those sold in smaller packages or sizes are also in high demand, as well as cookies made with healthier ingredients. Cookie ingredients are generally more closely monitored for allergy concerns, providing a solution for consumers worried about food allergies. Since many baked goods are no longer allowed at school functions, many consumers are turning toward retail bakeries for cookies and other allergen-free baked goods. In the grocery and mass channels, portion-controlled packages are giving cookies a boost. Even the poor economy helped lift cookie sales, as consumers turned to comfort foods to deal with the stress of the recession. Retail bakeries have also been successful in bundling cookies with other products. In 2016, sales of cookies in retail bakeries increased by 5.5% to \$214.3 million. Over the next few years, cookie sales will continue to grow at a solid rate, with indulgent, upscale varieties leading the way, as well as message and personalized cookies. From 2016 to 2021, cookie sales in retail bakeries are expected to increase by an average of 4.8% per year, totaling \$271.6 million in 2021.

- Like some cookies, doughnuts have not been a popular choice among health-conscious consumers, but those looking for an indulgent treat have been attracted to a variety of new doughnut flavors and formats. In 2016, sales of doughnuts in retail bakeries shot up by 7.6% to \$136.4 million. The current buzz surrounding doughnuts will continue over the next few years, as sales rise at a considerable rate. Better-for-you varieties balanced with indulgent offerings will contribute to the category's sales growth, as well as innovative variations like bacon-topped or apple-filled donuts and ethnic options such as dulce de leche. From 2016 to 2021, sales of doughnuts in retail bakeries are projected to grow by an average of 6.7% per year, totaling \$188.7 million in the latter year.
- Pies and other sweet goods (such as sweet rolls, coffeecake, pastries, danishes, and muffins) will continue to be a strong source for sales growth in retail bakeries over the next few years. In 2016, sales of pies in retail bakeries

increased by 4.3% to \$98.1 million, while sales for the other sweet goods category grew by 5.9% to \$3.48 billion. Mini, sliced, half, and handheld pies will anchor overall pie sales over the next few years, similar to what has occurred in the cakes category. Smaller portion sizes should attract more small-household shoppers and spark additional non-holiday purchases. From 2016 to 2021, pie sales are expected to grow by an average of 4.3% per year, totaling \$121.3 million. Meanwhile, sales of other sweet goods will rise by an average of 5.4% per year during the same period, totaling \$4.52 billion in 2021. Whoopie pies, which are a hybrid cookie, pie, and cake product, will be one of the more popular products in the other sweet goods category during this time, as well as other hybrid products like the cronut (a croissant-doughnut pastry), crookie (a cookie-croissant), and duffin (a doughnut-muffin). Other products providing solid growth in this category will include muffins, brownies, and fruit tarts. Like most bakery products, small or mini-sized varieties will be most attractive to consumers, while gluten-free baked goods and those made with simple, healthy ingredients will capture a larger audience.

- In 2016, sales of bagels in retail bakeries increased by 1.6% to \$24.0 million. Bagels have made a modest comeback over the past few years, following plummeting sales during the recession. Poor economic conditions and high unemployment rates led consumers to cut back on breakfast expenditures away from home in 2009, but a strengthening economy has given the segment a boost since then. Nonetheless, sales of bagels in retail bakeries will continue to advance at a slower pace compared to overall industry growth. Sales are expected to grow by an average of 1.3% per year through 2021, totaling \$25.6 million. Bagel sales will continue to be most prevalent in bagel shops and grocery stores, as its popularity fluctuates from year to year in retail bakeries.

State Sales Trends

- New York was the leading U.S. state for retail bakery sales in 2016, regaining the top spot in the previous year. In 2016, retail bakery sales in New York totaled \$745.7 million, accounting for 14.4% of the U.S. total. California was very close behind and was the only other state to account for more than 10.0% of total retail bakery sales with \$744.6 million, also representing a 14.4% share. Other significant state totals for retail bakery sales included Texas (6.6% share of the total), New Jersey (4.9% share), Pennsylvania (4.7% share), Florida (4.6% share), Illinois (3.9% share), and Michigan (3.6% share). Overall, there were 13 states with at least \$100.0 million in retail bakery sales in 2016. These top 13 states also accounted for an overwhelming 69.4% of total sales. The remaining states with retail bakery sales of at least \$100.0 million included Connecticut, Ohio, Massachusetts, Washington, and Wisconsin.

Number and Location of Retail Bakeries

- The number of retail bakeries in the U.S. grew by 2.2% to 6,756 establishments in 2016, following a 1.4% decrease in 2015 and an 8.5% spike in 2014. Prior to 2014, the lingering effects of the economic recession led to a 6.2% drop in the number of retail bakeries in 2013. This was preceded by two years of significant industry expansion in 2012 and 2011. Poor economic conditions, tighter credit restrictions, and slower consumer spending led to a drop in the number of retail bakeries in each of the previous three years. The end of the low carb craze and the popularity of high quality baked goods have made retail bakeries a more attractive business, not to mention the fact that it could be quite profitable. Including an estimated 1.1% increase in 2017, the number of retail bakeries in the U.S. will inch up by an average of 0.5% per year from 2016 to 2021, reaching 6,941 establishments in the latter year. Specialty bakeries that generally focus on one line of products, such as cupcakes or doughnuts, are not

included in this total. The number of these establishments will grow at a much faster pace over the next few years.

- California accounted for the largest number of retail bakeries in the U.S. in 2016. In 2016, there were 1,087 retail bakeries in California, representing 16.1% of the U.S. total. New York followed with 913 retail bakeries, accounting for 13.5% of the total. Texas, New Jersey, and Pennsylvania rounded out the top five states based on number of retail bakeries with 435, 346, and 325 establishments, respectively. Other leading states included Florida, Illinois, Michigan, Ohio, and Massachusetts with 302, 272, 236, 198, and 191 retail bakeries in 2016, respectively.

Average Sales Per Bakery and Gross Margins

- In 2016, the average sales per retail bakery in the U.S. increased by 3.7% to \$764,491. Over the past few years, retail bakery sales have generally been outpacing the growth in the number of these establishments, resulting in rising average sales per store. From 2011 to 2016, the average sales per retail bakery grew by an average of 5.5% per year. This type of growth will continue through 2021, making this an attractive business for investors. Including an estimated 5.6% increase in 2017, average sales per retail bakery are expected to grow by an average of 4.9% per year from 2016 to 2021, totaling \$970,984 in the latter year.
- The gross operating margin for retail bakeries in the U.S. fell each year from 2005 to 2008. High energy costs and skyrocketing ingredient prices (particularly for flour and other grains) led to the drop in gross operating margin during this time. In 2009, the gross operating margin for retail bakeries began to increase as gas prices fell sharply and ingredient costs stabilized. This upward trend continued in 2010, but the gross operating margin fell again in 2011 as operating costs rose moderately. Luckily, during the 2012 to 2014

period, the gross operating margin inched up before slipping back in 2015. The gross operating margin for retail bakeries quickly rebounded in 2016, but is expected to slip back through 2021. In general, the economic recession forced many bakeries to run leaner operations to preserve profitability. Some of the strategies included trimming labor costs, buying in bulk when possible, and negotiating costs with utility companies, insurance agents, and office suppliers. Going “green” is also helping reduce energy costs and waste. A significant trend over the next few years will be the move toward conserving resources and utilizing renewable resources to protect the environment for future generations.

- In 2016, the gross operating margin for retail bakeries was pegged at 30.5%. While reasonable prices for common ingredients and moderating energy costs positively affected the industry during this time, higher payroll costs and the trend toward using better quality and more exotic ingredients will result in a slight decrease in the gross operating margin through 2021. Prices for wheat, corn, soybean, sugar, cocoa, and vanilla prices will remain volatile over the next few years as droughts, natural disasters, and other unfavorable weather conditions become more prevalent. For example, vanilla bean prices skyrocketed in 2015 due to a poor harvest in Madagascar. Luckily, last year’s crop bounced back and vanilla prices returned to a more stable level. Despite the volatility, the gross operating margin for retail bakeries will only fall slightly from 2016 to 2021, including an estimated increase to 30.7% in 2017. In 2021, the gross operating margin will be 29.8%.

Competition from In-Store Bakeries

- Aside from uncertain economic conditions in the U.S. and abroad, in-store bakeries are currently the biggest negative factor affecting retail bakery sales in the U.S. In-store bakeries are no longer just found in supermarkets, they have penetrated mass market superstores and club centers. According to *Progressive Grocer* magazine, Costco, Wal-Mart Supercenters, BJ’s Wholesale, and

SuperTarget all have an in-store bakery in every one of their stores. Overall, the leading in-store bakery chains based on number of units include Wal-Mart Supercenters, Safeway Inc., Delhaize America Inc., Supervalu Inc., The Kroger Co., Publix Super Markets Inc., Ahold USA Inc., Sam's Club, Costco Wholesale Corp., and Winn-Dixie Stores Inc.

- After a period of significant growth, in-store bakery sales were stagnant in 2009, before growing at a modest rate during the 2010 to 2016 period. In 2016, in-store bakery sales grew by an estimated 2.8% to approximately \$14.6 billion. For the most part, in-store bakeries have performed well because of their focus on convenience and freshness. Healthier foods with more whole grains and less trans fat are fueling in-store bakery growth, as well as smaller portion sizes and low/no/reduced sodium, sugar, and fat products. More indulgent offerings are also gaining traction in these bakeries. As stated earlier, the desire to treat oneself in today's health-conscious society is contributing to the bakery industry's sales growth, however, retail bakeries tend to have an edge in product quality and innovation. From 2016 to 2021, in-store bakery sales will grow by an average of 2.2% per year, reaching an estimated \$16.3 billion in the latter year.

Consumer Price Trends for Bakery Products

- In 2016, consumer prices for bakery products inched up by 0.1%, following 1.4% and 0.4% increases in 2015 and 2014, respectively. Analyzing the last several years, U.S. consumer prices for bakery products jumped in 2008, as ingredient costs skyrocketed to historical levels. During this time, consumer prices for bakery products grew by 10.3%, following a 4.5% boost in the previous year. Luckily, prices for flour, grains, and other ingredients stabilized a bit in 2009, resulting in a 3.0% increase in consumer prices for bakery products. As retailers looked to attract more customers after a period of weak sales and ingredient prices remained tolerable, consumer prices actually fell by 0.4% in

2010. Unfortunately, this changed over the next few years, as prices for wheat, corn, soybeans, sugar, cocoa, and vanilla began to rise. In 2011 and 2012, consumer prices for bakery products rose by 3.7% and 3.1%, respectively, before increasing by 1.7% in 2013.

- The use of higher quality ingredients and continued volatility in common ingredient prices will contribute to a modest increase in bakery product prices through 2021. For example, vanilla bean prices skyrocketed in 2015 due to a poor harvest in Madagascar. Luckily, last year's crop bounced back and vanilla prices returned to a more stable level. Overall, consumer prices for bakery products are expected to advance by an average of 1.3% per year from 2016 to 2021, including an estimated 0.7% increase in 2017.
- Consumer prices for fresh cakes and cupcakes increased at the fastest pace in 2016, rising by 2.3%. In fact, this was the only major bakery segment to exhibit an increase in consumer prices during this time. On the other hand, consumer prices for frozen and refrigerated bakery products and crackers decreased at the strongest pace in 2016, falling by 0.6% and 0.5%, respectively. Over the next few years, prices for all bakery segments will trend upward. From 2016 to 2021, prices for fresh cakes and cupcakes will continue to advance at the fastest pace among bakery products (2.2% average annual rate), followed by fresh biscuits, rolls, and muffins (1.5%), fresh sweetrolls, coffeecakes, and doughnuts (1.2%), cookies (1.1%), frozen and refrigerated bakery products (1.0%), bread (0.9%), and crackers (0.7%).

Demographic Trends for Expenditures on Bakery Products

- In 2016, the average U.S. household spent \$356.25 on bakery products. This figure is expected to increase to \$383.75 in 2021. Among all bakery products, the average household spent the most on bread in 2016. During this time, the average household spent a total of \$107.25 on bread, which is expected to rise

to \$114.50 in 2021. Expenditures will continue to be highest for nonwhite bread. Meanwhile, average annual household expenditures on biscuits and rolls will grow from \$50.50 in 2016 to \$54.25 in 2021.

- Despite recent dieting trends, cookies were also a popular choice for U.S. households, as the average expenditures totaled \$50.50 in 2016. The average household is expected to spend \$54.00 on cookies in 2021. Average expenditures for cakes and cupcakes will grow at a solid rate during this period, increasing from \$39.00 to \$43.50, while expenditures for crackers advance from \$39.75 to \$42.25. Another category exhibiting moderate growth will be frozen and refrigerated bakery products. Household expenditures on these products will grow from \$29.75 in 2016 to \$32.00 in 2021. Lastly, average household expenditures on doughnuts, sweetrolls, and coffeecakes will increase at a considerable pace due to the popularity of doughnuts. Expenditures will grow from \$23.75 to \$26.00 during the 2016 to 2021 period, while expenditures for pies, tarts, and turnovers rises from \$15.75 to \$17.25.

- Consumers in the 35 to 44 year old age bracket had the highest average annual household expenditures on all bakery products in 2016 with \$424.00. Consumers in 45 to 54 year old bracket were close behind with \$393.00 spent on bakery products. This is not surprising since these consumers are generally parents with high disposable incomes. Consumers in the 55 to 64 year old age group were the only others to spend more on bakery products than the average household in 2016 (\$373.25).

- By region, consumers in the West spent the most on bakery products in 2016 with an average of \$375.50 per household. Consumers in the Midwest followed with average expenditures of \$368.25 on bakery products during this time. The Northeast and South regions were relatively far behind with \$357.00 and \$337.25 in average annual household expenditures on bakery products in 2016.

- Although bakery products are generally inexpensive, as household incomes rise so does the average spending. Consumers with a family income of \$100,000 and over had the highest average annual household expenditures on bakery products with \$543.75 in 2016. Consumers with a family income of \$80,000 to \$99,999 had the second most spending with \$445.75. In fact, consumers with family incomes of \$70,000 and above all had higher average annual household expenditures on bakery products compared to the average spending of all consumer units.

- White consumers had the highest average annual household expenditures on bakery products in 2016 with \$373.50. Asian consumers followed with average spending of \$346.50, while Hispanic consumers were close behind with average household expenditures of \$344.50 on bakery products in 2016. Hispanic consumers will be increasingly important to bakery producers over the next several years. Growing population and income figures will lead to more spending on bakery products. According to the 2010 U.S. Census, Hispanics account for approximately 16% of the U.S. population and is the largest and fastest growing minority group. The number of Hispanics grew from 35.3 million to 48.9 million from 2000 to 2010 and the Hispanic population is projected to grow to more than 60.0 million in 2020. In 2015, one-third of the nation's 19 year old and under population was Latino. More ethnic flavors, including tropical fruits and spices, will become more prevalent in the marketplace. Lastly, African American consumers spent the least with an average of \$243.25 on bakery products in 2016.

- Not surprisingly, the average consumer in households with a husband, wife, and children overwhelmingly spent the most on bakery products in 2016 (\$521.25). Consumers in households with just a husband and wife had the second highest average annual expenditures on bakery products with \$379.75. Meanwhile, single parents had average annual household expenditures of \$339.75, while single consumers only spent \$252.25 on average.

Economy's Impact on Sales

- The economy plays a moderate role in U.S. retail bakery industry. Consumers will always spend money on food and beverages, however, the types of products they purchase can vary. During poor economic conditions, consumers generally cut back on more expensive products. They also curtail spending on foods and beverages away from home. This was the case in 2008, and especially 2009, as the retail bakery industry was negatively affected by a rising unemployment rate and slower consumer spending. One of the few positive factors was consumers' willingness to treat themselves with a relatively inexpensive indulgence like a baked good. As the economy rebounded during the 2010 to 2016 period, the industry returned to positive sales growth. Solid growth rates are expected to continue for the industry through 2021. While the economy has gone from having a negative to a positive impact, volatile ingredient and energy prices will continue to be a challenge for the retail bakeries industry, along with rising payroll and healthcare costs.
- Analyzing long-term economic trends, the U.S. economy struggled greatly in 2001 and 2002, as the gross domestic product (GDP) grew by only 1.1% and 1.8% (in chained 2005 dollars) during this time, respectively. The economy began to recover in 2003, as the GDP grew by 2.5%. In 2004, a full economic recovery was in place and the GDP grew by 3.6%. The economy was strong again in 2005 and 2006, with slightly less GDP growth of 3.1% and 2.7%, respectively. In 2007, the economy slowed down and there was 2.1% growth for the year. Less growth was reported in 2008 (0.4%), as the economy was plagued by a poor housing market, financial turmoil and tighter credit restrictions, high energy costs, and weakening consumer spending. Most of these negative factors accelerated in 2009, as the GDP declined by 3.5%.
- In 2010, the economy rebounded with 3.0% growth in the GDP, as the housing market experienced a modest recovery, financial institutions stabilized, and

consumer spending increased considerably. Unfortunately, slower GDP growth occurred in 2011 (1.8%), as the lingering effects of the economic recession were prevalent. Nonetheless, the GDP picked up in 2012 with a 2.8% increase, which was followed by a growth rate of 2.2% in 2013. Stronger growth occurred in 2014 (2.4%), despite a contraction in the first quarter due to harsh winter weather. In 2015, the GDP rose by 2.6%, with a 1.6% growth rate reported in 2016. After an anticipated 2.3% increase in the GDP in 2017, steady economic expansion is projected through 2021.

Social Media a Vital Marketing Tool for Retail Bakeries

- Retail bakeries that become more tech-savvy will not only be better off during an economic downturn, they will be in a good position to capture more sales when the economy rebounds. Millennials are not shy about researching and purchasing items online and this group is catapulting social media marketing. An effective web site, Internet and social media (Facebook, Twitter, Instagram, Pinterest, etc.) marketing, and mobile device applications will be crucial in attracting this customer base in the future. More than 80% of Millennials are using smart phones and relying on these devices when shopping.
- Most consumers are interested in convenience and price so the Internet is a perfect fit. A web site and Facebook page enables consumers to view products online, educate themselves about certain types of bakery products, search for a variety of establishments, read reviews, and become more price conscious, all from the luxury of their own home or mobile device. Other social media sites, such as Tumblr, Pinterest and Instagram, can also provide a lot of free advertising for retail bakeries. Pinterest and Instagram, in particular, are two social media sites that allow companies to post detailed pictures of their businesses and the products they offer, as well as provide bakery product ideas and announce special events and other important news. Pinterest recently

overhauled its design, making images larger and offering similar items from a particular source when viewing a pin in a single format.

- Coupon use, which is at an all-time high, is also going virtual as many retail bakeries are now using coupon sites, such as Groupon, LivingSocial, and Restaurant.com. These sites not only offer coupons, they sell certificates for businesses that provide consumers with discounted prices after making an initial purchase. By 2021, more than 600 million consumers worldwide will use mobile coupons, resulting in nearly \$42 billion in savings. Currently, mobile couponing is most prevalent in the Far East and China, with North America and Western Europe quickly gaining ground.
- Social media and the Internet have become a core component of bakeries' operating strategy, as they help build brand awareness, boost interactions with customers, and allow companies to monitor what people are saying about their products. Social media also has an advantage in directly targeting specific demographic groups compared to traditional media marketing that is less focused. QR codes (quick response codes) can also be placed on items and scanned by customers' mobile devices to provide additional company and product information. Therefore, many bakery companies are shifting their marketing budgets to digital advertising. Nonetheless, when combined with traditional advertising techniques, social media and web marketing can propel retail bakeries to new heights.