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SPECIAL REPORT: Food Companies Work To Improve Safety -- And Rebuild Confidence

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DOWJONES

NEW YORK (Dow Jones) - Growing concern about food safety has led Julie Behounek to avoid supermarkets, processed food or even deli sandwiches.

"What's happened in the last year just highlighted everything I was concerned about," the project manager from Jersey City, N.J. said at a farmer's market in New York. "Profit motive is the No. 1 priority for food producers. We have to look out for ourselves."

In the year since three people died and more than 200 were sickened by E. coli after eating contaminated raw spinach, and other reports have surfaced about tainted pet foods, fish and peanut butter, food companies are facing growing pressure to regain trust of consumers, whose confidence in the safety of what they eat is at an 18-year low.

Companies have ramped up inspections, added food safety research budgets and are updating systems to avoid a misstep, which may not only lead to illness or death, but can also result in a battered corporate image, lost sales and market share. The changes are critical as the U.S. increases its imports and companies roll out products at a faster pace, leaving their traditional safety-check systems vulnerable.

"There's an absolute need for food companies to step it up," said Bob Allen, a principal at Archstone Consulting, which advises major U.S. food and consumer- products companies. "The supply chain has

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changed on food companies. A lot of it is under strain as a result of growth and innovation."

Confidence undermined

In response to growing safety concerns, the Food Marketing Institute, a trade association whose board members include chief executives of 81 companies such as grocery giants Wal-Mart Stores Inc. (WMT) , Kroger Co. (KR) and Safeway Inc. (SWY) , formed a task force in October devoted to food safety.

"There's a great interest by both the supplier community and retailers to identify and trace foods," said Jill Hollingsworth, FMI's group vice president of food safety programs. "Retailers want to know more about where foods come from. The old system is just not enough anymore."

A new system can't come soon enough. Only 66% of shoppers, the lowest since 1989, are confident that the food they buy at grocery stores is safe, according to a survey by the Arlington, Va.-based FMI, whose members represent three quarters of domestic grocery sales. That's down from 82% last year.

People are even less comfortable with restaurant food, with only 42% feeling safe about meals eaten away from home, the survey said. No fewer than 38% of consumers have stopped buying items, led by produce, meat and poultry, because of outbreaks and recalls in 2006, the association said.

The U.S. has logged about 5,000 deaths and 76 million cases of illness tied to food borne diseases each year, according to the Centers for Disease Control and Prevention's Web site.

Five food borne bacteria alone, including E. coli, cost the U.S. almost \$7 billion each year in medical costs, productivity losses and costs of premature deaths, according to the U.S. Department of Agriculture.

Eat local

Behounek said she was even more conscious of food safety because she grew up on a farm in Iowa. She buys mostly from local farmers' markets and has increased her organic food purchases to about 85% of her grocery shopping from about 50% in the past year, she said.

"It always seems to be better to eat local," she said. "You know where it comes from."

Retailers have expanded the safety training of employees, from store managers to deli and seafood workers, said FMI's Hollingsworth. They also are pushing suppliers to certify foods through third-party independent audits and request more detailed information about how products are made, such as the source of the water used to grow vegetables, she said.

"The sheer variety of choices we have from food as well as increased access to information make consumers think more about their foods," said Michelle Barry of research and consulting firm Hartman Group. "There's still a lot of consumer concern about how animal foods are being processed and cared for and some safety issues around E. coli."



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Evolving expectations

Tyson Foods Inc. (TSN) , the world's largest meat processor, has steadily increased its food safety research budget each year, said Hal Carper, Tyson's senior vice president of corporate research and development.

The company in January opened a 100,000-square-foot research complex, which includes a testing room to gauge product shelf life.

"The consumer is really barraged with worldwide news on questions concerning anything from food nutrition to safety," Carper said. "As their expectations have changed, we want to make sure we are on the leading edge."

Other food companies aren't sitting still and are increasing product inspections, testing or adding food safety staff.

Kellogg Co. (K) the largest U.S. cereal maker whose brands include Special K and Apple Jacks, requires its suppliers to meet independent, third-party audits. The company has requested additional third party audits as a "precautionary measure" amid reports on tainted foods that Kellogg wasn't part of, spokeswoman Kris Charles said.

"Our focus on quality control is always strong," said Kellogg CEO David Mackay in an interview. "The key is to maintain that."

Kraft Foods Inc. (KFT) , the largest U.S. packaged foods company, is pushing the industry to adopt uniform standards on sanitary equipment designs, spokeswoman Elisabeth Wenner said.

The absence of uniform standards means some equipment is more difficult to clean and maintain than others and may be more prone to bacteria growth, Allen said.

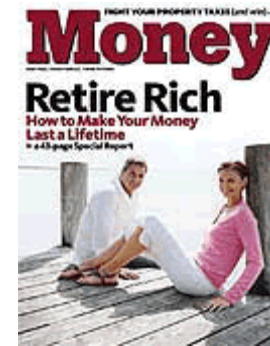
Product genealogy

As companies update their safety checks, advancements such as Web-based tracking tools and radio frequency identification have also become more readily available to help them trace foods.

"Technology and capability have gotten better so that we could detect more things than 30 years ago." said Jon Fisher of Fifth Third Asset Management, shareholder of food stocks including Kellogg. "Quality control can be better."

Milwaukee-based RedPrairie, a software firm that helps companies-- from Kraft and Tyson to General Mills (GIS) and Procter & Gamble Co. -- track their goods through the supply chain, has seen its sales to food and beverage companies rise at its fastest pace in at least 10 years as more of them use technology to track products, said Matt Reinke, who manages the firm's relationships with its food and beverage customers.

For example, companies such as PepsiCo Inc. (PEP) and its Quaker unit are using RedPrairie's software to



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help them map "product genealogy," which traces the life cycle of products from store shelves all the way up to the ingredients and raw materials that make them, he said.

"Our products are coded, labeled, identifiable and traceable," PepsiCo's spokeswoman Jenny Schiavone said, without providing more details.

Rebuilding confidence, from spinach to peanut butter

The cost can be high for companies whose products fall into categories associated with tainted goods. Not only do they have to bear the expense of any potential recalls, winning back lost customers may also be hard to do.

Tyson's beef sales had been hurt since Japan and other countries blocked some U.S. beef imports in 2003 on concerns over mad cow disease.

Banana producer Chiquita Brands Inc. (CQB) said this month that North American demand for its Fresh Express salad was still sluggish after an industry E. coli outbreak in spinach last September dampened consumers' confidence in bagged salads.

"It takes time to build consumer confidence," said Chiquita CEO Fernando Aguirre. "You have to not only talk about your superior quality but also talk about your food safety."

Chiquita, which wasn't the cause of the outbreak, has implemented stricter field requirements and more inspections. It also is ramping up marketing spending and is testing new products such as single-serve full-meal salads.

ConAgra Foods Inc.'s (CAG) profit declined in its largest unit, hit by recall costs after its Peter Pan peanut butter was linked to salmonella. Procter & Gamble (PG) said this month its snacks, coffee and pet care unit posted the lowest quarterly growth against other segments after the recall of its Iams and Eukanuba wet pet foods.

Rising imports, rising stakes

The increased vigilance on the part of retailers and producers has paid off somewhat. The number of food recalls tracked by the U.S. Food and Drug Administration has declined each of the past five years to 214 in 2006.

But it could be better. Only between one in five to one in six companies believe their supply chains are as effective and efficient as they can be, according to data from consultant Bain & Co.

"Some of the companies are fantastic while others are laggards," said Tanya Roberts, an economist in food safety with the USDA's Economic Research Service. She said government fines or liability may prompt companies to take even more action on food safety.

The stakes are rising, as agricultural imports this year are expected to jump 72% to a record \$70.5 billion from \$41 billion in 2002 as Americans consume more foreign foods including wine, coffee and candy, according to a May report from the USDA. The increase puts more responsibility on food companies because the FDA inspects only about 1% of U.S. food imports.

Another challenge to food safety is staying on top of the thousands of new products rolled out each year. In order to excite consumer demand and lower costs to boost profit, most U.S. companies are targeting 20% or more of their sales from new variations each year and relying more on third-parties to make and co-pack their products, adding more players into the supply chain, Archstone's Allen said.

"When everybody tries to improve profit margins and cut back expenses, more likely something will slip through the cracks," said Alan Lancz, president of money manager Alan B. Lancz & Associates Inc., former shareholder of food stocks such as H.J. Heinz Co. (HNZ) "It's definitely a concern."

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