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Twenty Years of Competition Reshape the U.S. Food Marketing System

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■ Warehouse club stores, drugstores, and other nontraditional foodstores have increased their share of food sales, leading traditional foodstores to compete to retain their share of consumers' food purchases.

■ Advances in communication technology and increasingly diverse consumer preferences have led to more customized food marketing strategies.

■ Food companies are touting their socially responsible corporate practices as a way to attract customers.

The past 20 years have brought significant changes in structure and competition in the U.S. food marketing system. Wal-Mart opened its first supercenter in 1988, offering food items as well as department store merchandise. Since then, the company has become the Nation's leading retailer of grocery products. Warehouse clubs, dollar stores, drugstores, and natural and organic foodstores have also made their mark in the food industry, each with a unique mix of products, services, and pricing strategies. Foreign-owned retailers and restaurants and other foodservice options also are sources of competition for U.S. consumers' food dollars.

Traditional grocers are finding ways to survive in the new marketplace with cost-cutting and marketing strategies to differentiate themselves from the competition. Traditional food retailers are experimenting with new store formats and upscale store brands.

More fragmented advertising venues and consumers' desire to express their individuality are enabling greater segmentation of customers based on specific preferences. Appealing to the social consciousness of consumers offers companies another means of standing out from the competition and diversifying their product offerings. As food companies strive to maintain market share in the domestic food economy, largely limited by population growth, consumers are the beneficiaries of this heightened competition through diverse product offerings, new and improved services, and competitive prices.

Nontraditional Foodstores Make Inroads Into the Food-at-Home Market

The influx of retailers not traditionally involved in food sales has been one of the most important developments over the past two decades. Supercenters, for example, offer a wide variety of food and nonfood merchandise, often at lower prices than traditional foodstores, such as supermarket chains, convenience stores, and specialty foodstores. Warehouse clubs, including Costco and Sam's Club, compete by catering to small businesses and to middle- to upper-income consumers, offering a limited variety of products and a grocery section dedicated to large-size packages and bulk sales. Drugstores, including CVS, Walgreens, and Rite Aid, attract consumers with a pharmacy, snack and convenience foods, and, in some stores, frozen and refrigerated items. Dollar stores, such as Dollar General, Dollar Tree, and Family Dollar, appeal to bargain and low-income shoppers with products priced at $1 or $2.

Nontraditional outlets have increased their share of U.S. food purchases for at-home use, from 13.8 percent in 1988 to 32.6 percent in 2006. Most of this growth was due to supercenters and warehouse club stores, which accounted for 17.9 percent of food-at-home expenditures in 2006.

"Fresh" Formats, Globalization, and Foodservice Outlets Add to Competitive Mix

In addition to the influx of nontraditional retailers, other sources of competition in the U.S. food industry come from the foodservice sector, globalization, and "fresh format" stores that emphasize perishables, typically ethnic, natural, and organic products. From 1999 to 2006, sales at the two largest publicly traded fresh-format stores, Whole Foods and Wild Oats, grew by 275 and 64 percent, respectively, compared with a 22-percent increase for all grocery stores.

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Traditional grocery retailers continue to face indirect competition from the food-away-from-home segment, which captured 48.9 percent of total U.S. food expenditures in 2006, up from 45.4 percent in 1988. In addition to their traditional menu items, foodservice companies have added a host of new products in response to health-conscious consumers, such as McDonald's apple, grape, and walnut salad, and KFC's roasted-chicken choices.

Foodservice chains are also competing by improving service. Many of these full-service restaurants, such as Outback Steakhouse and Carraba's Italian Grill, have emphasized take-out orders by adding reserved parking spaces and special entrances. In 2004, full-service chains' take-out sales accounted for an estimated 10 percent of their total sales, growing at roughly twice the rate of their total sales over the previous 3 years. Limited-service restaurants, such as Burger King and McDonald's, have extended their hours of operation and expanded their breakfast menus.

Some of the fastest growing foodservice chains have been those catering to consumer preferences for "casual indulgence" with more upscale items, such as specialty coffee and breads, gourmet ingredients, and organic and natural prepared foods. They include limited-service chains such as Starbucks, Panera Bread, and Quiznos Sub. In 1987, Starbucks began its

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rapid ascent by selling quality beverages tailored to individual tastes and by promoting an image of luxury and sophistication. The company continues to grow, opening 1,065 new stores in 2007, compared with 11 in 1988 and 357 in 1998.

Globalization has meant that domestic retailers face increasing competition from foreign retailers operating in the United States. U.S. sales by foreign grocery retailers, including Ahold (Netherlands), Delhaize Group (Belgium), and A&P (Germany), totaled $85.6 billion in 2005, or 17.7 percent of foodstore sales, up from $22.1 billion (6.8 percent) of foodstore sales in 1988. Tesco, the United Kingdom's largest grocery retailer, is the most recent entrant into the U.S. food retailing market (see box, "British Retailer Enters U.S. Food Fight").

Traditional Food Retailers Bite Back With Differentiation Strategies . . .

In response to an eroding market share, traditional grocers are expanding the number and types of product offerings, designing new store formats, and using innovative in-store technologies. Leading supermarket chains are expanding their private label (store brand) and organic product lines. Store brands originally were positioned as less costly alternatives to name brands but retailers now are introducing premium store brands, such as Food Lion's Taste of Inspirations and Kroger's Private Selections. Publix recently opened its first GreenWise store that features organic produce, meats with no added hormones, and healthful prepared foods, along with select conventional items. The store is named after Publix's line of private label organic and natural food products. Kroger (Naturally Preferred), Giant Food (Nature's Promise), and Shaw's (Wild Harvest) also offer corporate-brand organic or natural products.

Courtesy of Fresh & Easy

British Retailer Enters U.S. Food Fight

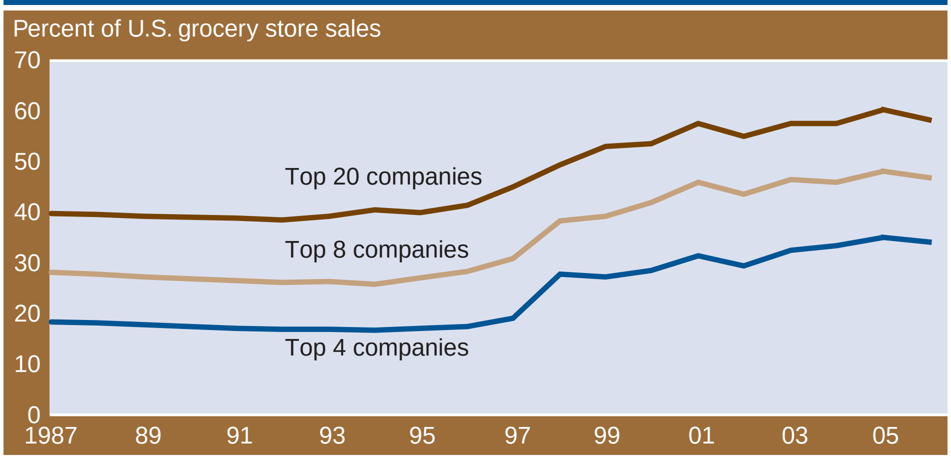
In November 2007, British retailer Tesco became part of the U.S. food retailing landscape with the opening of its Fresh & Easy Neighborhood Market stores in southern California and Las Vegas, NV. Tesco is a formidable competitor that ranks as the leading grocery retailer in the United Kingdom and third-largest retailer in the world, after Wal-Mart and Carrefour (France). Tesco competes in a mature market in the U.K. that has grown very little over the past 20 years. But Tesco has expanded to account for over 30 percent of U.K. grocery retail sales.

Tesco's U.S. stores average about 10,000 square feet in floor space, about the size of a large convenience store, and considerably smaller than an American supermarket. The U.S. Tescos feature an extended selection of prepared meals and entrees for time-pressed consumers. In addition to offering convenience, the products emphasize health concerns with labels like "no transfats," "no artificial colors," and "no preservatives." The smaller stores are tailored to meet local consumer needs and to reduce time spent shopping for traditional grocery items. About half of current U.S. offerings sold at Tesco stores are the Fresh & Easy store brand, many of which address environmental, local agriculture, and animal welfare concerns on their labels.

Initially, Tesco plans to open 200 stores by the end of 2008, mostly in Las Vegas, NV; Phoenix, AZ; and southern California. The speed at which Tesco is planning to open its stores is testimony to the intense competition in the U.S. food retail market. The faster Tesco can open its new stores, the less time competitors will have to replicate the concept before it gains a foothold in the U.S. market. Tesco unveiled the new stores under a shroud of secrecy. For example, at one location, the company tested the layout of a mock store by building it inside of a warehouse hidden from view and shipping the food in from the U.S. East Coast.

The eventual impact of this British vendor remains unknown. Other European retailers, such as Sainsbury's, Marks & Spencer, and Carrefour, have been unsuccessful in their efforts to compete in the U.S. market with European store formats. However, Tesco was apparently affecting the U.S. grocery sector even before its first store opened. Kroger, which competes in the same U.S. markets that Tesco has targeted, has been opening more of its Fresh Fare stores, which are smaller than a typical supermarket but larger than Fresh & Easy. Safeway indicated that it, too, might consider smaller format stores similar to Fresh & Easy.

Growth in sales shares of largest grocery retailers has moderated since 2000



Sources: U.S. Census Bureau, Monthly Retail Trade Survey; company annual reports; *Supermarket News*, various issues; and *Progressive Grocer Marketing Guidebook, 2008*.

Many traditional retailers are designing stores that offer consumers an upscale shopping experience. Safeway is opening "lifestyle" stores featuring high-quality produce, accent lighting, products organized by meal solutions, and additional offerings such as classes on cooking and flower arranging. Kroger Marketplace, which is twice as big as a regular Kroger store, features a Starbucks coffee bar and Donato's Pizza stand. The stores also have more nonfood merchandise such as bath towels, bed linens, office supplies, and patio furniture. A&P is expanding its upscale Fresh Market concept, featuring natural and organic produce and restaurant-style hot and chilled foods.

Supermarkets also are adding more goods priced at $1, fuel pumps, and prepared deli foods. As supermarkets compete with the foodservice sector, the annual sales of prepared foods sold in supermarkets are growing at about 4 to 4.5 percent, compared with 2 to 2.5 percent for their other food items.

Innovative, time-saving technologies offer another means for traditional grocers to differentiate themselves from competitors. One of the fastest growing technological applications in new grocery stores is self-checkout lanes. In 2005, nearly 56 percent of food retailers used self-checkout systems, up from 38 percent in 2004. More advanced technological applications in some stores include in-store self-scanning with automated checkouts, and biometric technology that allows preregistered customers to pay at checkout by scanning a finger.

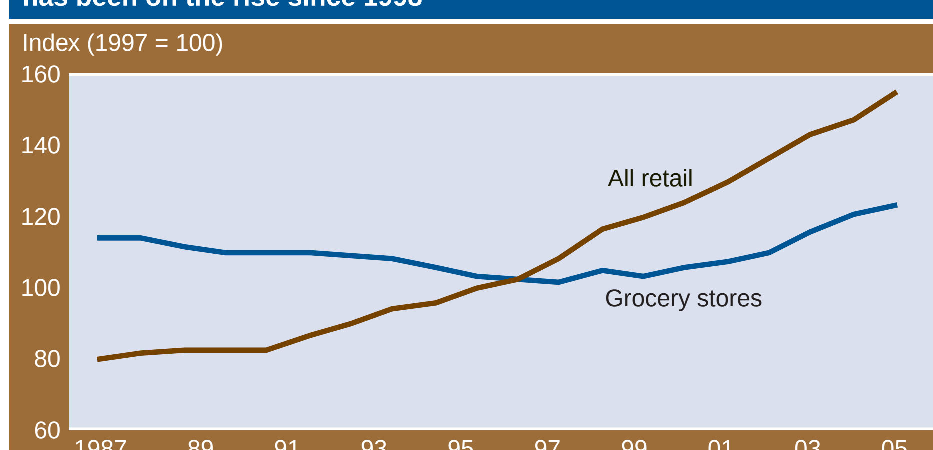
. . . and Cost-Cutting Strategies

Traditional food retailers are responding to the lower prices of the "big-box" stores such as supercenters with a number of strategies to improve efficiency and lower operating costs. These include consolidation through mergers and acquisitions to capture economies of scale, and restructuring operations to increase efficiency and cut costs. In grocery retailing, consolidation has moderated following sharp increases in national concentration since 1997.

To improve inventory control and monitor sales, traditional food retailers emulated Wal-Mart's innovative logistics system, which created an online network for collaboration and data sharing with suppliers. The result has been more efficient management practices and increased consistency in product and invoice data used by food suppliers, which allowed retailers to reduce out-of-stock items and excess store inventory.

U.S. Bureau of Labor Statistics data indicate that labor productivity (output per hour) in grocery stores has been on the rise since 1998, following years of decline. This may reflect consolidation in the retail grocery sector, more rapid adoption of new technology, and other efficiency-enhancing moves. Rising labor productivity has helped traditional retailers compete better with price-oriented competi-

Output per hour worked at traditional grocery retailers has been on the rise since 1998



Source: U.S. Bureau of Labor Statistics.

tors by reducing labor costs, which account for about half of operating costs.

Is There a Resurgence in the Traditional Retail Food Sector?

As savvy retailers learn to compete in a slowly growing domestic food economy, recent sales figures point to a possible resurgence by traditional outlets. Since 2003, there has been a slowdown in the loss of market share for this category. According to Willard Bishop, a food company consulting firm, the share of grocery sales accounted for by traditional supermarkets fell by only 0.6 percentage points in 2006, compared with 3.4 and 1.9 percentage points in 2004 and 2005, respectively.

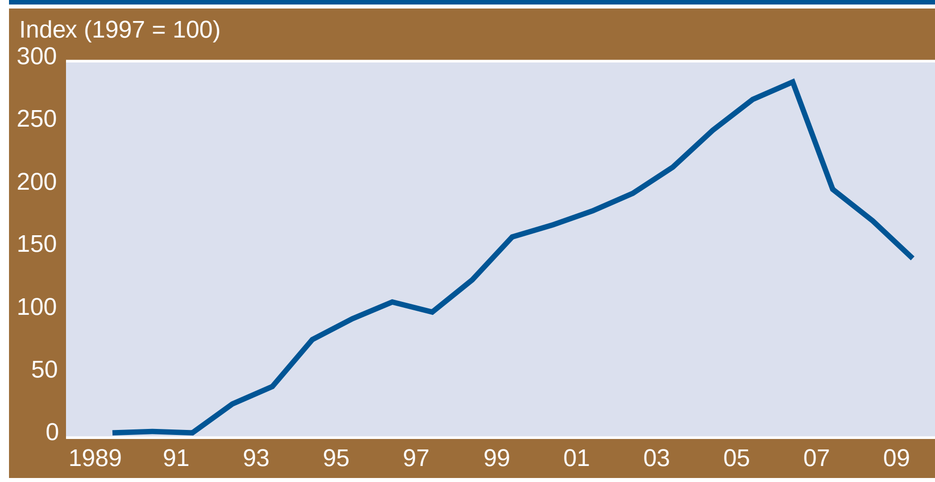
Another factor pointing to a possible resurgence by conventional food retailers is a slowdown in the growth of Wal-Mart supercenters. The company expects to open 25 fewer U.S. supercenters in 2008 and 30 fewer in 2009, compared with each previous year. This follows a longterm upward trend in supercenter openings since 1991. Instead, the company plans to concentrate on investments in its international operations.

Food Marketers Use New Media To Target Consumers

The share of food and beverage (excluding alcohol) manufacturers' media budgets spent on TV advertising fell from 81 percent in 1990 to 64 percent in 2006, illustrating a fragmenting of food advertising media over recent decades. The decline may reflect TV commercial-skipping technologies, such as TiVo, difficulty in measuring ads' effectiveness, and the growing variety of advertising options, including Internet sites and video games.

The Internet accounts for only 2 percent of food manufacturers' advertising expenditures, but it is becoming increasingly important in targeting children, with games and contests built around the

Number of U.S. Wal-Mart supercenter openings projected to decline



Note: Wal-Mart projections for 2007-09.
Sources: Company annual reports and press releases.

brands. Other Internet options include search-related advertising and social networking sites, such as MySpace and Facebook, which allow advertisers to reach a specific demographic segment.

Some companies are turning to video games, cell phones, in-store advertising, and product placement in entertainment programs to tout their brands. To attract teenagers, Coca-Cola is creating a cellphone networking site for its Sprite brand, similar to online social networking sites. Kroger announced plans to offer in-store television broadcasts that, besides delivering information on new products and promotions, will allow food manufacturers to air commercials. Each store will have programs specific to its location. Food company brands are also featured in movies and at sports events, such as the National Association of Stock Car Racing's (NASCAR) Nextel Cup. PepsiCo Inc.'s

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Mountain Dew recently financed a documentary on snowboarding, and the brand could be seen occasionally in the movie.

Another factor contributing to more customized marketing and product offerings is changing consumer preferences. The convergence of labor-force participation rates between men and women has increased the value of households' time and convenience foods. New information about the relationship between diet and health has led to increased demand for more healthful foods. As wealthier consumers seek new experiences and ways to broaden their tastes, new niche products allow consumers to express their individuality and social position through food purchases.

Product proliferation, in part, serves the needs and desires of different consumer segments. Each year, thousands of new food and beverage products are introduced. From 1988 to 2007, the number of new product introductions rose by 181 percent. Based on new product claims tracked by Datamonitor, a leading international supplier of information on new packaged products, health and convenience-related attributes accounted for 7 of the top 10 subject categories for claims on packages in 2007. Five of these categories have ranked in the top 10 since 2001, including "natural," "organic," "single serving," "quick," and "fresh." From 2003 to 2007, "upscale" ranked as the leading new product claim category, including "unique" and "premium" products.

Food Companies Tout Their Socially Responsible Activities

Food manufacturers, retailers, and foodservice establishments also see greater social responsibility as a way to gain a competitive edge. One of the biggest developments in the global business world over the past 10 years has been the emergence of the Corporate Social Responsibility (CSR) movement. CSR shifts the emphasis from traditional government regulation of corporate conduct to the promotion of corporate disclosure of activities that address social issues. In part, this is a response to more socially conscious consumers, who are increasingly aware of the effect that their consumption choices have on others. CSR also offers companies another means of segmenting the market based on consumer preferences for products, such as Fair Trade coffee and American Humane Certified™ foods (certification program of the American Humane Association).

As part of CSR, firms engage in socially beneficial activities that extend beyond government mandates. Slaughter plants, for example, must adhere to Federal requirements for the handling of animals such as access to water, abuse prevention, and other factors related to humane treatment. However, meat companies are also applying voluntary animal handling guidelines that exceed Federal requirements, such as minimum pen space, and handling methods that reduce animal stress.

One indication of the importance of the CSR movement is the voluntary reporting by corporations of information that goes beyond what is required by law. Many of the largest companies have started producing social, environmental, or sustainability reports in addition to their traditional financial reports. In 2005, 32 of the 100 top U.S. companies published stand-alone CSR reports. Among leading food companies in 2006, CSR reporting was more extensive in food manufacturing and foodservice. Since 2006, Wal-Mart, the leading U.S. grocery retailer, and Kroger, the second leading U.S. grocery retailer, have introduced their own dedicated CSR reports.

Among leading food companies, the most common CSR-related topics are environment, community development, and nutrition. Other common areas of reporting included animal welfare and contributions to education. Several food companies, including Pepsico, Tyson Foods, Ahold, and Starbucks, report a Global Reporting Initiative (GRI) index in their CSR reports, which provides standardized guidelines for reporting progress on corporate economic, environmental, and social performance (labor, human rights, society, and product responsibility practices).

Courtesy of Safeway, Inc.

Competitive Forces Have Marketing and Policy Implications

Intense competition over the past two decades in the U.S. food marketing system has spurred innovations and cost efficiencies. Consumers have access to a wider range of products, services, and store formats that appeal to their preferences for convenience and quality. U.S. consumers are enjoying the new stores and an array of value-added products—such as fully prepared Italian stuffed shrimp, low-carb mashed cauliflower, and Japanese-style tempeh, among many others—at relatively modest price increases. The CPI for food and beverages in the U.S. increased by an annual average of 2.9 percent from 1987 to 2006, compared with 3.1 percent for all retail items (except food and beverages). Over the same period, the share of disposable income spent on food declined from 11.5 percent to 9.9 percent.

Consolidation in the U.S. food marketing system can provide a means for attaining cost efficiencies, but can also change bargaining power between buyers and sellers, which is monitored by government agencies. Antitrust policy decisions regarding mergers and acquisitions can become more complicated as stores use strategies to compete with alternative formats. For example, in 2007, the Federal Trade Commission contested natural and organic retailer Whole Foods Market's acquisition of Wild Oats on the grounds that consumers would be harmed in geographic areas where both previously competed. The Commission also argued that other retailers that sold organic foods were not close substitutes to the merging stores. Whole Foods argued that the organic market had expanded to include traditional supermarkets that have increased their organic product offerings and opened stores similar to Whole Foods. The judge ruled in favor of Whole Foods.

Growing awareness by food companies of how they are perceived by consumers has important marketing implications for the entire supply chain. Companies that engage in corporate social responsibility reporting in areas such as animal welfare create additional marketing opportunities through adoption of alternative production practices. Burger King and Hardee's recently announced that they will purchase a percentage of their pork from suppliers that do not use gestation-sow stalls, which can constrict movement. However, the feasibility of adjustments in production methods will depend on the additional costs involved and whether consumers will pay higher prices for products produced in a more socially responsible manner.

Continually evolving consumer preferences, advances in communication technology, and the increasing diversity of food outlets over the past 20 years have contributed to the shift from mass to more customized products and services. Specializing in certain segments provides a means for firms to compete in a slowly growing food market. W

This article is drawn from . . .

The U.S. Food Marketing System: Recent Developments, 1997-2006, by Steve W. Martinez, ERR-42, USDA, Economic Research Service, May 2007, available at: www.ers.usda.gov/publications/err42/

You may also be interested in . . .

The Impact of Big-Box Stores on Retail Food Prices and the Consumer Price Index, by Ephraim Leibtag, ERR-33, USDA, Economic Research Service, December 2006, available at: www.ers.usda.gov/publications/err33/

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