An Update on the Canadian Home Meal Replacement Market

by Kevin Grier
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Summary Points

While Home Meal Replacement may not be the Knight in Shining Armor we thought it might have been, it is still the industry's best hope for growth and profits in the future. Even better than that, HMR provides an array of opportunities for companies of all sizes. In fact, it is the smaller firms which have been the quickest to capitalize on many of the areas of success.

Three to four years ago, the concept and strategies of Home Meal Replacement, were regarded by industry leaders in both Canada and the United States as a key to success. Not only was HMR going to be necessary for inter-grocer competition, but more importantly, it was said to be crucial in the battle against the foodservice sector. The vision was of a growing, profitable HMR department in every store.

The Food Marketing Institute (FMI) in Washington, defines HMR narrowly in its Glossary of Supermarket Terms as "foods prepared in a store and consumed at home or in-store which require little or no preparation on the part of the consumer." Others have defined HMR more broadly. For example, Jim Reynolds of the Beef Information Centre defined HMR as "any product with a convenience or added value component."

The underlying consumer trends are also in favor of broadly and narrowly defined HMR. A recent report on meatingplace.com says that for the first time since the 1991-92 recession, Americans are turning back to their kitchens for meal preparation. But they're not cooking so much as heating up an array of frozen pizzas, entrees and meat products. These are among several key findings in market researcher NPD Group's 16th annual Report on Eating Patterns in America, released last month.

As outlined in the report below, the message of HMR whether broadly or narrowly defined is one of opportunity. In good economic times or bad, consumers are always going to look for convenient, easy to prepare foods or foods that are already prepared for them. This is also an area where big does not remotely mean better. The rewards will go the both branded or non-branded manufacturers as well as big and small retailers. However defined, HMR is going to continue to attain the industry's best intelligence and a lion's share of its monetary resources.

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The Food Marketing Institute (FMI) in Washington, the US grocery industry association, was the leader in promoting the merits of HMR. Canadian Council of Grocery Distributors and the Food and Consumer Products Manufacturer members were also on-board. The FMI defines HMR narrowly in its Glossary of Supermarket Terms as "foods prepared in a store and consumed at home or in-store which require little or no preparation on the part of the consumer." Others have defined HMR more broadly. For example, Jim Reynolds of the Beef Information Centre defined HMR as "any product with a convenience or added value component" at a CCGD meeting in 1999.

Foods Prepared In-Store

Measuring the progress of HMR is a challenge. With regard to HMR as defined by FMI, the difficulty in measuring progress is the lack of data. For example, A.C. Nielsen of Markham does not have a definition for it, nor a defined category. Nielsen's clients come up with their own definitions/descriptions that include a variety of different categories. Another challenge is the inconsistency of HMR operations. Most HMR activity is still taking place in the deli departments. When trying to determine HMR growth, the question becomes whether items such as salads and casseroles in the deli are a part of HMR, or just natural extensions of deli offerings. Furthermore, some HMR operations are separate from the deli. The challenge in measuring true HMR success is whether those salads etc. that are still in the deli should be counted as HMR revenues. Individual firms know the answers to these questions but those answers cannot be tabulated for the industry as a whole. From an industry perspective, as of now, measures of progress are only subjective or qualitative.

In that regard, category managers of deli, HMR and instore-foodservice departments from the Maritimes to BC acknowledge that progress is only a fraction of where the industry thought they would be or wanted to be just four years ago. Stumbling blocks have included:

- food safety
- labor availability and skill
- shrink
- quality and consistency

In addition to the above, HMR product costing methodologies and profit measures have been ambiguous and elusive. Grocers also failed to initially understand the magnitude of gross margins necessary to succeed. One foodservice sector rule of thumb would place necessary gross

margins at 60-70%. Those gross margins are required even with minimum wage employees. That is compared to grocers who often have fully unionized labour. Grocers initially flinched at margins that high without understanding the high operating costs that quickly erode those gross margins. Couple that with the grocer's innate tendency to turn every category into a pricing battlefield and you get a recipe for losses.

Furthermore, the real competition, the restaurant or foodservice industry, did not sit still. As a competitive strategy against foodservice, HMR success was statistically ineffectual. Until September 11 of this year, the foodservice sector continued to gain share of stomach and dollars at the expense of the grocery store. The quickserve sector in particular continued to expand menus and reduce customer waiting time. McDonalds in Canada, for example, has challenged employees and franchises to speed up service while at the same time developing new kitchen systems to reduce product standing time. While McDonalds Canada does not provide data, at many Canadian franchises the drive-through is reported to be around 60% of the business.

Quickserve restaurants also continued to work to expandtheirmenu and enhance product quality. Once again, McDonalds is a good example. A new strategy outlined by McDonald's in the US includes new menu initiatives such as McPick Value Meals, which allow customers to build their meals from a set of entrees and side dishes and the addition of beef and chicken sandwiches to its New Tastes Menu rotation. The company plans to open 25 dessert and snack units next year; expand the Chipotle gourmet burrito chain in 200, with 70 new units, and continue with its Boston Market turnaround effort with a new sandwich test (source: Food Institute Daily Update, November 1).

The message for grocers is that the competition is not going to let-up with regard to speed, quality and choice. In other words, the challenge between HMR fake-KFC and the real thing is not going to get any easier.

This does not mean that HMR has been a failure. Instead of big strides, however, over the last four years the Canadian grocery industry has seen tentative, small scale success. The industry has learned from its larger failures and continued to offer improved, more profitable HMR to consumers. The industry is also learning the realities of what is possible with regard to merchandising and profits. Moreover, the industry is learning on its own. The benchmarks that Canadian grocers were supposed to emulate, like Boston Market for example, have gone out of business (a failing BM was bought by McDonalds). In addition, HMR managers have learned that the gritty reality of HMR means understanding the importance of hair nets and the dangers of cross contamination. Those realities are far less thrilling than originally advertised.
With regard to revenues, a dynamic and flourishing deli-HMR combination in the store can result in that area being responsible for 10-15% of store sales. A more standard, well-run deli-HMR share now amounts to 9-10%. That compares to less than 5% in the early 1990's. Those operations that are knowledgeable about what is required, are fixing gross margins at the 60% mark. Deli-HMR managers that have a handle on their operating costs can in turn generate the highest net profits in the industry. For reference, in a good year operating net is less than five percent for the store. A well run HMR could bring back two times the store average. More typically managed HMR's are now starting to move into breakeven or better.

The expansion of revenue and share of store for an area that brings back above average or potentially above average net profits is always going to be a plus. Furthermore, grocers can apply a key marketing skill that is innate: cross merchandising. Fresh pasta, sauces, wines can

easily be cross merchandised with HMR. Well managed departments are designed to generate incremental volumes from other areas.

Perhaps more importantly, HMR has become a signature component of a successful store or banner's merchandising mix. While it may not be statistically possible to show that HMR has competed well against restaurants, there is no question that HMR is now an important tactic for competition between grocers. The consumer need for convenience is as great as ever. A good HMR program that delivers high quality prepared foods at reasonable prices does deliver competitive advantage over stores that do not have the offering. Partial proof of that fact is the now familiar $4.99 or $5.99 loss-leader barbeque chicken. BBQ chicken has now become a standard feature in most supermarkets. The bird might not be Tide or Coke, but it is a key product. Another element of proof is the fact that HMR departments are continuing to grow. The shelf/table/case space has been growing in small increments, but it is growing. Over the last five years, deli-HMR space has likely expanded by at least 30%. Additionally, the HMR section is now increasingly standing independently of the deli. One estimate places 25% of HMR operations separate from the deli department. In most new Loblaws the HMR is stand alone. If they weren't a competitive necessity, the trend would have been the opposite.

Those HMR departments that have been successful so far have followed through on the following tenets:

- emphasize a few menu items that can be done well
- be consistent across banners
- emphasize food safety
- emphasize employee training
- centralize cooking and/or let suppliers provide near finished product
- make the gross margins pay for the operations

One fundamental difference and strength to these value added HMR offerings is that the need for a national brand to appear on a prepared product is lessened by the quality commitment from the retailer. This strengthens each and every store for the same reasons that private label retailer brands can. Consumers will become loyal to a specific store offering in the fully prepared meal category and will not easily accept another store's same product offering. While this is a strong point for well-managed businesses, it is the challenge for chains to manage the consistency of the offering.

In the future, narrowly defined HMR departments ("Foods prepared in a store and consumed at home or in-store which require little or no preparation on the part of the consumer") are going to continue to grow as grocers learn from watching those that are most successful. The narrowly defined HMR will grow because grocers know that it has to grow in order for them to succeed. Those that do it well will see strong contributions to the bottom line. Those that don't will see a continued large drain.

Broadly Defined HMR is a Success for the Industry

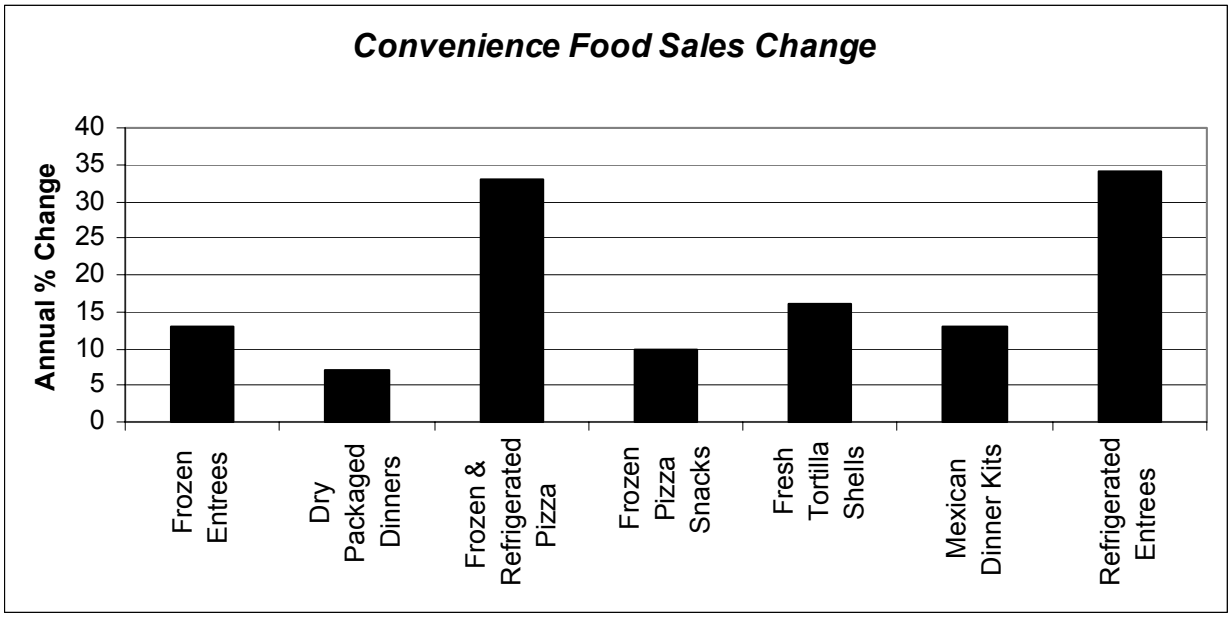
The more broadly defined HMR, “Any product with a convenience or added value component,” has been a clear success for grocers. First we saw ready to consume salads in produce areas that often included every thing needed to mix the salad all in one convenient package. This section is now dominating the produce categories for sales and profitability, at the expense of the

ingredients needed for salads. Nevertheless, its acceptance by consumers and the sheer volume has been astounding and arguably incremental. This convenience factor in produce was part of a new and evolving value equation that led the way to more involved, made in store salads and salad bars. Melons are now regularly found year around cut into smaller portions and/or mixed into fresh store made fruit salads. In the produce departments today there are most certainly 2-3 skus of washed carrots, washed celery sticks, 2-3 skus of garlic in oil, individual servings of salad dressings, precut vegetables and other prepared ready to consume fresh produce offerings.

The next areas to see product innovation were the frozen food offerings from the grocery and meat departments of the supermarket. Initiatives around value added frozen boxed meats led way to fully prepared meals ideal for microwaves or ovens. A top quality Lasagna could be on the table for a family or an individual in less than an hour. Products such as family sized meat pies, macaroni and cheese, value added fish products and much more began to dominate sales. To further grow this area many specialty dishes, once only available at restaurants, were launched, including wild game dishes and exotic pasta and rice mixtures. Frozen Pizza sales gave way to fresh store made pizzas and more authentic value added offerings often with ethnic origins to tempt the consumer.

In the dry grocery setting, quieter changes such as more “just add water” or “just add meat,” and easy to prepare "skillet" dinners were being added. In addition, complete dinner packages and value added products from canned meats and fish through to pasta dinners, rice mixtures and ready to serve soups are all now a part of the center aisles.

The following graph shows the percentage change in year over year sales for the 52 weeks ended July 14 for a series of convenience oriented food products sold by Canadian grocery stores. The data was supplied by A.C. Nielsen of Markham, Ontario.



The graph shows a range of growth rates from Dry Package Dinners at 7% to Refrigerated Entrees at just less than 35%. The key point to note is that total grocery sales growth rates in Canada have amounted to only 4% so far this year. Even the “slower” growth convenience items are growing far in excess of the industry as a whole.

Another point to note with regard to these broadly defined HMR items is that not only are they the fastest growing component of the store, but they are also among the strongest profit performers of the otherwise flat-lined grocery department. These items are still in the stage of the product life cycle where the gross margins have not been drained out of them. Demand is strong enough that they do not need to be priced at the bare minimum. In fact premium margins are the norm. Even better for grocers, most of the best performers, particularly in the frozen aisle, are private label. Better margins on a private label product that is growing at double digits is always going to be very welcomed by grocers.

It is also important to mention the changes to in-store merchandising as end displays started to reflect the ingredients needed to follow select recipes. In addition, advertising often included recipes or tips for quick and safe in-home meal preparation. Demos and sampling have increased followed by actual cooking classes and demonstrations, all aimed to educate the consumer about the fun and ease of meal preparation. Manufacturers formed strategic alliances to cross merchandise brands in order to better support this vital consumer message. These are the types of activities that grocers have long said they needed in order to bring life back to the middle of the store.

Where were the national brand manufacturers in all of this change and opportunity? They were for the most part as far behind the translation of HMR into retail as the retailers themselves. In addition the national brand manufacturers were managing an internal conflict between their food service sales and retail sales departments. Initial requests for products were seen as challenges to the food service sales effort and were often shrugged off by the manufacturers as not a retail opportunity.

As such, while the national brand manufacturers waited, the private label manufacturing community rallied to the early demand and opportunity. These private label manufacturers were leading many of the value added product offerings found in Canadian stores in the beginning and still are today. By the time the national branded manufacturers came in with product offerings, they were seen for the most part as duplications of what was already available or listed. The situation was the same in the perishables areas. The difference in perishables, however, was that rather than brand issues it was more the unique product requirements being asked for by the retailer that presented the challenges. As in the other areas, the smaller more flexible manufacturers drove the initial product offerings as well.

Consumer Trends Still Favor all Types of Convenience Foods

The underlying consumer trends are also in favor of broadly and narrowly defined HMR. A recent report on meatingplace.com says that for the first time since the 1991-92 recession, Americans are turning back to their kitchens for meal preparation. But they're not cooking so much as heating up an array of frozen pizzas, entrees and meat products. These are among several key findings in market researcher NPD Group's 16th annual Report on Eating Patterns in America, released last month.

The meatingplace.com article says that Americans had already started to cut back on restaurant meals long before the September 11 attacks. Consider that annual meals eaten in a restaurant per person dropped from 66 in 1999 to 64 in 2000. Americans are also ordering fewer take-out meals--averaging 70 meals per person annually in 2000, down from 73 per person in 1999. What's behind the decrease? Almost every food manufacturer now offers convenient heat-and-eat

products that are generally less expensive than a restaurant meal. This bodes particularly well for frozen food processors. Last year, Americans served a frozen meal dish with 11.5 percent of suppers, up from 9.4 percent just four years ago, according to an NPD news release. Homemakers are also serving more frozen pizzas, frozen entrees and frozen meat dishes.

The message of HMR, whether broadly or narrowly defined is one of opportunity. In good economic times or bad, consumers are always going to look for convenient, easy to prepare foods or foods that are already prepared for them. This is also an area where big does not remotely mean better. The rewards will go the both branded or non-branded manufacturers as well as big and small retailers. However defined, HMR is going to continue to attain the industry's best intelligence and a lion's share of its monetary resources.

Versions of this report appeared in the November and December issues of Grocery Trade Review. The George Morris Centre's Grocery Trade Review is a monthly publication which provides subscribers with analysis of issues and trends of the trade between grocery manufacturers and retailers. For a free sample copy of Grocery Trade Review, please contact Kevin Grier at 519-822-3929x202 or kevin@georgemorris.org