Agricultural Outlook Forum 2003 Presented: Friday, February 21, 2003

OPPORTUNITIES AND CHALLENGES FOR FLORICULTURAL PRODUCERS SELLING TO A CHANGING MARKETPLACE

Dr. Marvin N. Miller
Market Research Manager
Ball Horticultural Company

Producers of floricultural products are facing both challenges and opportunities in today's marketplace. While breeders have provided new varieties at a dramatic pace in recent years, which has helped to keep the consumer interested in the industry's products, the demands of retailers are probably having a greater influence in shaping the marketplace for all of those in the market channel, with the possible exception of the consumer, herself. Indeed, retailers are competing for market share, and in their efforts, they are changing the picture of floriculture as seen by both the consumer to whom they sell and the producers from whom they buy.

Introduction

At the consumer level, the floricultural marketplace can best be viewed as divided between so-called "traditional retailers" and mass marketers. Traditional retailers or "independents" would include retail florists, who tend to focus on cut flowers and cut flower arrangements for special occasions, and garden centers, which, in addition to their traditional inventories of trees and shrubs and, in recent decades, bedding/garden plants, are increasingly carrying more and more potted flowering and foliage plants.

On the mass market side of the ledger, supermarkets have become the primary vendors of everyday cut flowers for the home, as well as the everyday vendor for potted flowering plants. Increasingly, supermarkets are also being viewed as vendors of holiday flowers and plants purchased for gifts. Some supermarkets also carry foliage plants quite regularly, and some, in selected markets, have started to sell bedding/garden plants seasonally.

Another mass marketer type would be the discount store; these retailers include the likes of Wal-Mart and financially-troubled Kmart and tend to focus on bedding/garden plants in the spring and potted flowering plants for Easter and Christmas. Some also include foliage plants in their offerings. In cases where these retailers have added perishable groceries to their mix (e.g., Wal-Mart SuperCenters and Super Kmarts), cut flowers may also be part of the retail format. Target, which had been very involved seasonally in the bedding/garden plant market throughout the country, has reduced this involvement to Florida, California, and selected other southwestern states, where there is more of a year-round market and where they have built permanent garden centers alongside their stores. Nationally, Target maintains a small foliage plant display in most stores, and they carry blooming holiday plants for Easter and Christmas.

The other dominant mass marketer type is the home improvement/hardware/home center, dominated floriculturally by Home Depot and Lowe's. These retailers focus on bedding/garden plants to accompany their lines of trees and shrubs and lawn and garden hard goods (garden tools, fertilizers and chemicals, lawn mowers, hoses and sprinklers, etc.), but they also carry both potted flowering and foliage plants on a weekly basis in established garden departments. At Easter and Christmas, these retailers also display racks of lilies and poinsettias throughout their stores.

The Industry from the Consumer's View

The consumer is very divided by the various retail opportunities for floricultural products. First, it must be noted that there are very few retailers who carry a mix representative of all four of the major industry segments: cut flowers, potted flowering plants, foliage plants, and bedding/garden plants. Hence, retailers practically force the avid consumer of floricultural products to shop among several retailer types to see the full array of product opportunities. And there are some industry statistics to suggest that consumers are shopping around more and are spreading their purchases among more and more retailers.

Secondly, retailers vary dramatically in the selection offered, as well as the qualities, quantities, and sizes demanded from their vendors, and in the products and services they provide. Hence, if the consumer has particular needs in mind, they may be forced to shop around to find their ideal. Certainly, pricing varies among the retailers, as well.

Working on the side of many retailers is the overall ignorance of the majority of consumers about the industry's products. For mass marketers, the lack of knowledge of the average floricultural consumer makes retailing a generic selection of dominant varieties and colors quite acceptable, especially if the retailer is able to attract consumers through the lowest price. For the traditional retailer able to attract the flower or plant aficionado through better quality, wider selection, or better service, the niche opportunities provide their *raison d'être*. Yet, consumers increasingly report they are realizing that if they know what they want and they are looking for the bread-and-butter staples, they can get a great deal by buying at mass marketers, as long as they get to the retailers as fresh product arrives.

Producer Challenges

The evolving marketplace has certain challenges for the grower. In many instances, buyers for mass marketers have added what must be considered artificial conditions to the buying arrangements. Some buyers have added "pseudo grades and standards" to plants based on shelving heights or personal preferences, rather than based on generally accepted plant-to-pot ratios; sometimes these conditions are set only to allow the retailer to better exhibit various differences among groups of plants being sold at different price points. Premium versus promotional plants being sold side-by-side provides an example. Ironically, such conditions *are* sometimes making it easier for the uninformed consumers to recognize differences for their dollars. However, growers are sometimes forced either to sell perfectly acceptable plants at discounts because their dimensions fail to measure up to a particular buyer's prerequisites or to culturally curtail plant growth to keep plants within the standards.

Growers also are forced to choose among production strategies. On the one hand, growers producing for mass marketers typically will grow large quantities of a limited number of outputs in highly automated operations. On the other hand, growers producing for independents typically will grow fewer numbers of a wider selection of outputs in much less-automated surroundings. Such "either-or choices" are difficult to make, whether made from the marketplace or the production perspectives, and do not contribute to operating efficiency or business risk reduction.

Consolidation of Customers, Markets, and Buyers

Consolidation of retailers has also presented some not-so-obvious marketing challenges for growers. There are instances in the marketplace where buyers are placing real or suggested limits on producers about which competitors they can also sell to or on how much of a producer's output they are willing to buy. The restraint of trade issues notwithstanding, such actions limit producer options. Growers rightfully want to spread their eggs among as many baskets as possible, but options are dwindling as certain chains account for greater market shares and as financial realities force smaller chains and/or independents from business.

In many markets, the big box chains often come onto the scene opening huge store numbers in a relatively short time. While this is the nature of mass markets, these actions, which have forced less organized retailers from the scene, have also had the effect of forcing producers to scramble to maintain any market opportunities to which they can sell. Sometimes the chains enter a new market and bring established supply relationships with them from distant locations, rather than developing new relationships with local producers. With alternative local retailers pressured, local growers often find themselves challenged to find an inviting market channel.

Conversely, as chains move from market to market, a number of buyers have asked growers to supply not only those stores that have been supplied in the past, but the additional stores being built or acquired. Due to production or servicing constraints, additional volume is often beyond the means of certain suppliers. For the sake of buying efficiency, chain buyers have sometimes changed suppliers to those willing to add production volumes. There have also been instances where a chain has changed the buyers or their responsibilities, forcing producers to again compete and establish relationships with the new buyers.

Pay Changes on the Horizon

One phenomenon affecting growers is the relatively new auction buying by a number of chains, particularly supermarkets. Perhaps caused by consolidation and/or centralization of buying functions, a number of chains have asked growers to participate in on-line reverse auctions to bid for their business. In such instances, purchases are made from growers willing to supply to a set of predetermined and written specifications, which are published on-line. Thus, superior quality is not encouraged nor rewarded, as the product is seldom seen by buyers. Instead, growers are forced to produce to the minimum standards to remain as competitive as possible.

Another decision being considered by several chains is whether or not to move to a pay-by-scan transaction basis. Today, most chains pay for the product delivered. But several chains are considering moving to paying only for the product scanned at checkout. This would force producers to absorb all of the shrink now assumed by retailers. It might also force growers to modify their product and/or service protocols to help assure getting paid for their efforts. More frequent deliveries of smaller quantities per delivery and the servicing of retail displays are two possible examples of changes growers will be forced to make. Cash flow considerations are another concern. This pay-by-scan change would benefit the retailer, who will be able to radically reduce inventory dollars from their books. Such a move would increase the retailer's return on assets, something of particular importance to Wall Street, as market opportunities become more limited due to store saturation.

Structural Impacts on the Industry

The impacts of the mass marketers on the floricultural industry are tremendous. To their credit, many would argue that the chains have exposed many more consumers to floriculture. There is no doubt that this is true, as the presence of mass marketers has opened not only the consumers' eyes to the industry's products but additional market opportunities for producers as well. Mass marketers have also facilitated the growth of the offshore cut flower producers to develop into the major suppliers that they are of cut flowers and greens. In recent years, offshore producers have also become providers of many cut flower bouquets now offered at retail, products formerly assembled not only in the U.S. but near the cities in which they were sold.

Domestically, the impact of the mass marketing of floricultural crops has led to the increased formation of larger and larger producer operations. The capital requirements needed to afford the infrastructure required to move mass quantities of product in a confined marketing window exceed those that this industry has historically managed. Most firms have been able to amass the capital on their own, but the industry also has seen examples of investment brokers entering the industry to help finance some of these production operations. The financial returns of many of these brokers' acquisitions have not met Wall Street expectations.

In many instances, chain buyers have limited the number of firms with whom they deal in any market area, as chains have come to realize certain efficiencies when it comes to merchandising products if fewer vendors are utilized. Chains have begun asking vendors to provide care for in-store displays, especially during the bedding/garden plant season, something that is easier to request if one firm handles all of the merchandise. Whether or not producers are rewarded for the additional expense of providing fully managed displays is debatable, but some growers report that the improved product care leads to additional turns, which provide the needed results.

There are also several instances of producers partnering with several smaller firms in order to handle the volumes required to supply burgeoning chains. In one instance, there may be as many as 40 growers involved in cross-docking activities to satisfy one chain's needs in one market area. Depending upon the arrangements, this helps to spread the risk among several producers. Still, there are numerous examples of producers who supply 50%, 75% or even 100% of their output to one chain; when asked about risk, these growers often respond with discussions about production efficiencies and questions about what they could do even if they wanted to change, noting that their competitors would love to steal the account.

In contrast, the focus on mass marketers by large growers has created opportunities for smaller growers to develop niches serving independent retailers or to go into retailing themselves, selling directly to the consumer. In a recent survey of growers, it was found that the majority of several thousand producers surveyed did some retailing of their own, whether that was 1% or 100% of their production. Smaller growers appeared to sell higher percentages, on average, of their production at retail. Yet, some larger producers have also used their own retail as a tactic for diversification. In many instances, producers in the middle seemed to focus their production on selling to independent retailers, perhaps, including a retail operation of their own.

The other impact of mass marketers on the industry has been one of consolidation. In recent years, grower numbers have appeared to decline from year to year, or at best, remain stable. One could debate why the producer numbers are diminishing, but many would argue that the stresses of either supplying mass marketers or competing with them as an independent grower-retailer are taking their toll. The capitalization requirements, the reduced margins, the increased demands, the risk associated with fewer customer numbers and the resulting consequences should that risk come to be realized have all created market pressures for larger producers. The struggle to remain competitive in a viable niche for smaller producers can be equally trying in markets being inundated by competing chains. There are already certain markets where independents hardly can be found.

The long-term consequences are uncertain, but the need to recognize the consumer's role in supplying derived demand for the entire market channel must be recognized. If the consumer develops a negative impression of the industry's products or for how those products are presented by a particular retail giant, this could have dire consequences for industry growth. Keeping the consumer intrigued is important, and one could argue that mass marketers and/or those supplying their stores must collectively take some responsibility for assuring the industry's future in this regard.