CHOICES
a publication of AAEA Agricultural & Applied Economics Association
The Magazine of Food, Farm and Resource Issues

4th Quarter 2010 | 25(4)

THE CHANGING FACE OF FOOD RETAILING

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JEL Classifications: L1, M1, L2, L8
Keywords: Food Retailing, Food Trends, Food Consumers, Grocery Purchasing

This article explores current and possible future trends in the food retail value chain, particularly in relation to Michael Porter's five forces, plus the impact of technology and another major driver of change, the most severe economic downturn since the Great Depression. (Porter, 1979)

The rapid spread of supercenters and deep-discount food retailers illustrates Porter's threat of the entry of new competitors, after supermarkets had been the predominant food retail format for several decades. The growth of private-label products reflects both Porter's risk of substitute goods and the power of product buyers. In terms of technology, the analysis of the point-of-sale (POS) data generated by checkout scanners and barcodes has helped shift bargaining power from the product suppliers to the increasingly-concentrated retailers. The next major technological innovations may be the use of radio frequency identification, with substantial effects on the food retail value chain, and mobile-marketing coupon distribution through cellular phones. Finally, the deep recession caused households to economize on their food spending, which may have longer term impacts on consumer food purchasing behavior.

New Food Retail Formats

Porter's threat of the entry of new competitors is well illustrated by the rapid growth of supercenters—big-box stores such as Walmart, Target, and Costco that sell both general merchandise and a full-line of the most popular food products. Costco is actually a wholesale club store and shoppers must be members as is the case with Sam's Club, owned by Walmart, but the club stores compete in many respects with supercenters and conventional retailers. In addition, deep-discount, limited assortment food retailers selling less than 2,000 items, such as Aldi and SUPERVALU's Save-A-Lot, have grown rapidly. Aldi is one of the largest German food retailers and by early 2010 had 1,084 stores in 31 U.S. states (Bustillo and Martin, 2010). The expansion of Aldi's U.S. operations and its sales have clearly benefited as households looked to save on their food purchases.

These new formats have increased the competitive rivalry/pressure on traditional supermarkets. Virtually all the new Walmart stores opened in the last several years have been supercenters and a number of older stores have been remodeled and enlarged into supercenters. Walmart is now the largest U.S. food retailer and groceries accounted for 51% of its total store sales in 2009 (The Packer, 2010). Target, considered more upscale than Walmart, has been opening most of its new outlets as Super Targets, with a full grocery operation on one side of the store, while also remodeling older stores.

Supercenters have a different objective for their grocery operations than traditional supermarkets, whose ultimate objective is the profitability of their food operations. For Walmart and Target supercenters, the goal is overall store sales and profitability; food is often used to raise customer traffic and the spillover of shoppers to the general merchandise side of the store, increasing the sales of higher profit margin categories. Food more than general merchandise is particularly useful for driving up the frequency of shopper visits. Therefore, supercenters are willing to accept lower margins on food sales than traditional supermarkets, according to food-retailing executives. In addition, most supercenters operate with far fewer distinct product items, called stock keeping units (SKU's). Walmart, in particular, usually has the lowest prices in most market areas, with the exception of the deep-discount stores.

Both Walmart and Target supercenters have greatly improved their grocery operations since they first started, especially in the fresh produce section. Target has used its own distribution system for dry groceries, but has sourced its fresh produce through SUPERVALU, the largest U.S. food wholesaler/distributor. Walmart at first depended on other firms to source and transport products to its distribution centers. For example, Walmart relied on C.H. Robertson and others to buy from the growers in California and elsewhere, and deliver to Walmart distribution centers a large share of its fresh produce. Walmart has since changed its whole approach and is now doing more of its own sourcing and distribution, with the goal of driving costs out of the system, which has always been a key competitive advantage (Birchall, 2010). Walmart now has its own produce buyers in the major growing regions, such as California and Florida.

The growth of supercenters has brought a wave of consolidation to the retail food industry. Many small, frequently family-owned operators of one to several stores have lost the most sales to the new formats and gone out of business or been taken over by larger chains. This trend is likely to continue into the foreseeable future. In addition, large traditional supermarket chains, such as Kroger and Safeway, may increasingly suffer from the intensity of the competitive rivalry from these new formats. Interestingly, Walmart has announced that much of its future expansion will focus on smaller urban stores, rather than big-box, suburban supercenters (Bustillo and Martin, 2010).

The Growth of Private-Label Products

An excellent example of two of Porter's forces, the risk of substitute products and the power of product buyers, is the rapid growth of private-label goods—also referred to as store brand or own brand—by supermarkets and other food retail formats. Grocery private-label sales grew by 9% in 2009 (*The Economist*, 2009). In 2008, 97.5% of food retailers indicated they were offering private label/store brands as a key part of their merchandising strategy. The private label share of total sales increased from 16.5% among U.S food retailers in 2006 to 18.2% in 2008 (The Food Institute, 2009). Private label accounted for 35% of Kroger's sales, the highest share of any major U.S. supermarket chain. Most food retailers have substantial room to continue to grow their private-label offerings, when compared to Germany where they account for almost 40% of sales (*The Economist*, 2009).

The deep-discounters, Aldi and Save-A-Lot, offer around 95% and 80% private-label products, respectively (Bustillo and Martin, 2010). Trader Joe's, a unique U.S. grocery format focused on value-priced upscale products, enjoys very strong customer loyalty and has been expanding rapidly even in the recession. Trader Joe's, which is privately owned by the same German family as Aldi, relies extensively on its own store-brand products.

Private-label products typically cost consumers about 25% less than the national brands, such as Kraft, Kellogg and General Mills. Moreover, the quality of private-label goods has greatly improved and many consumers may never go back to the national brands, even when the economy fully recovers. Most supermarkets still stock the top national brands in a category, such as Kellogg and General Mills in breakfast cereal, but the brands that are not in the top one or two in terms of market share may have vanished from the shelves. Even for top national brands, stores may have cut back on the number of package sizes offered and facings to make room for more private-label items

In most stores, including Walmart and Target supercenters, private label is stocked close to the major brand, so customers can easily compare the cost savings. On a visit by one of the authors to the Walmart Supercenter in Stillwater, Minn., their store-brand, "Great Value" Frosted Flakes, selling for $2.50 for 23 ounces, was right next to Kellogg's Frosted Flakes at $2.98 for the same 23 ounces (prices for November 12, 2010). A 2-liter bottle of "Sam's" Zero Coke was 78 cents compared to Coca Cola's Coke Zero for $1.48. Interestingly, "Sam's" soft drinks were shelved at the far end of the aisle in a very small area with Pepsi and Coca Cola products dominating the section, which might suggest some type of compensation for shelf placement, referred to as a "slotting allowance", or just the power of the national brands.

Many retailers are using a two tier private-label approach, one price-oriented and the other more quality-focused. Super Target is a good example, with its lower-priced "Market Pantry" products, while "Archer Farms", its other store brand is meant to denote quality. Store brands are attractive to retailers because their profit margins are typically higher than on national brands. With their analysis of POS data, retailers are better positioned to forecast product sales and match production and inventory of private-label products to final customer demand than are manufacturers of national brands. Another reason for the rapid growth of store brands is that “retailers have masterfully shifted the consumer consciousness from generic to private label” according to Karl Halpert, CEO of Private Label Select (The Food Institute, 2009, p. 87). Many consumers now think of private label as representing the best value—quality at a lower price.

Most retailers do not manufacture their private-label products, but contract with a food processor for manufacturing. In a number of cases the store brands are actually manufactured by the national-brand companies in their plants, since they benefit from the economies of scale. Malt-O-Meal, known for its hot breakfast cereal, runs a large plant in Northfield, Minn., which produces private-label cold breakfast cereal. When one of the authors was on a plant tour several years ago, they were producing cereal for the Kroger supermarket chain. Some retailers, such as Kroger, do operate their own processing plants, most frequently in dairy (The Food Institute, 2009).

Technology Driven Value Chain Changes

One of the greatest changes in the food retail value chain in the last 25 years has resulted from the use of POS data by retailers to better understand consumer purchasing behavior, and thus improve everything from inventory management to product promotion. Because retailers have this data and the knowledge it provides, their bargaining power in relation to their suppliers has been greatly strengthened. The balance of power shifted from those previously with the most bargaining power, the suppliers, to the retailers starting in the 1980s. Much of the impact of this shift had largely occurred before 2000.

Retailers can now identify which items are selling well and which are not. Between 1996 and 2008, the number of SKU’s carried by the average food retailer increased by 50% to 47,000. To streamline the shopping experience for customers, who had become overwhelmed with the number of choices, many stores have now reduced their product selection, by as much as 15% (The Food Institute, 2009).

The next major technological advance impacting retailers’ supply chain is radio frequency identification (RFID), which involves microchips that can be read by radio wave from a distance, replacing barcodes. Walmart has taken the lead among retailers in investing in the new technology and requiring its suppliers to adopt RFID. Although adoption has been slower than originally planned because of technical and cost issues, most of Walmart’s largest suppliers now must have RFID tags on every pallet and/or case shipped to its distribution centers. One industry analyst predicts Walmart will achieve annual cost savings of over $400 million with pallet and case RFID, and much more if individual items are RFID tagged someday (Research Recap, 2010). One benefit would be the reduction in the occurrence of out-of-stock items in stores due to the improved inventory control made possible by RFID.

The growth of smart phones with a myriad of applications, including location pin- pointing, is opening a wide range of new marketing possibilities. One potential use is sending electronic product coupons based on a consumer’s location in a grocery store, which is likely to evolve over the next few years as individual retail chains offer it on an opt in basis, meaning consumers will choose whether to participate.

The Great Recession: A Major Driver of Change

A major driver of recent change for retail food, including food stores, or groceries, and food service, or the restaurant side, of the business has been the substantial shifts in consumer food purchases due to the severe 2008-2009 economic downturn and very slow recovery. The food spending of households that were directly affected by the loss of a job or home to foreclosure changed the most. Even many families not directly impacted, given the uncertainty and concern for their future financial situation, became more frugal in their spending. Consumers ate away-from-home, at restaurants, less frequently and were looking for greater value in their grocery purchases. Many experts believe that, just as with the Great Depression, some of these consumer changes will become permanent, such as the greater frugality, and be part of what has been referred to as the “New Normal” (Davis, 2009). Consumer spending began to pick up in early 2010, although at a slower pace than when emerging from past recessions.

Some consumers, who had been buying natural and organic, began to question the price premium for these products. Whole Foods, the upscale natural and organic food retail chain, saw its identical, same store sales— a key metric in retailing—fall by 4.3% in fiscal year 2009, after years of robust growth, as consumers sought lower prices (Whole Foods, 2009). In response, the company revamped its strategy to provide greater value to consumers. The “365” store brand, which is value-oriented with a lower price point than comparable products, was expanded to new categories. Whole Foods’ more value-oriented strategy, combined with the stabilization of the economy, has succeeded in turning the situation around with comparable store sales again growing.

Casual sit-down restaurant chains, such as Applebee’s and TGIF, suffered substantial sales declines in the recession, whereas some fast food chains saw sales grow, as consumers traded down to economize. In the midst of the recession in 2009, McDonald’s U.S. comparable store sales actually grew by 2.6% (McDonald’s, 2009). Restaurants are promoting more aggressively now than previously. Quick-service, fast food, outlets have adopted the “dollar menu”; casual family restaurants are doing more “kids eat free” and adding specific lower-priced menu selections on certain days; and more upscale, fine dining restaurants are discounting wine on slower nights, such as Sunday-Thursday. Across the board, restaurants have adjusted their menus to capture a more value-oriented consumer. In 2010, restaurant business began to improve along with the economy, albeit slowly (NRA, 2010). Although people are cooking more at home, take-out food has been less affected than dining out, since pizza delivery or a ready-to-eat meal from the supermarket can substitute for going out to a restaurant, providing a break for weary home cooks.

Concluding Observations

Most of these trends are likely to persist into the foreseeable future. The market share of grocery sales by supercenters and of private-label products should continue to grow, although perhaps at a slower pace. New technologies, such as RFID for logistics and electronic coupons sent to smart phones for marketing, will become more widely utilized.

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