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Grocery Retailers Demonstrate Urge To Merge

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Two blockbuster mergers were announced in 1998 involving the largest-ever combined sales by food retailers. Kroger, already the largest grocery retailer in the United States with 1997 sales of $26 billion, merged with Fred Meyer to form a multiregional supermarket operator with $45.3 billion in combined sales in 1999 (table 1). The merger resulted in the combined sales accounting for an estimated 10.4 percent of total grocery store sales, which reached $434.7 billion in 1999, including sales of supermarkets, superettes, convenience stores, delicatessens, and smaller grocery stores. With Fred Meyer operated as a wholly owned subsidiary of Kroger Company, the combined firm operates 2,288 supermarkets in 31 States and 816 convenience stores in an additional 6 States.

Also in 1998, the fourth-largest U.S. food retailer, Albertsons, initiated its merger with second-ranked American Stores—operator of Lucky Stores, Jewel, and Acme Markets—resulting in combined sales of $28.9 billion, operating 1,690 supermarkets in 38 States. These mergers are part of a recent strategy among the largest U.S. grocery store retailers to maintain their leading positions while considerably growing in size both by merging with or acquiring other grocery retailers (table 2 and fig. 1).

Mergers and acquisitions have enabled grocery retailers to quickly become larger by purchasing existing stores rather than building new ones. Prior to 1998, both Kroger and Albertson's had grown primarily by building stores in new locations and regions. Although mergers and

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Table 1
Sales of the 20 Largest Food Retailers Totaled $232 Billion in 1999

Rank/retailer		Supermarkets owned	U.S. grocery store sales[1]
		Number	*Billion dollars*
1	The Kroger Company/Fred Meyer	2,288	45.3
2	Albertson's, Inc./American Stores, Inc[2]	1,690	28.9
3	Safeway Stores, Inc[3]	1,659	25.5
4	Ahold, USA	1,063	20.3
5	Wal-Mart Supercenters[4]	721	15.7
6	Winn-Dixie Stores	1,188	13.9
7	Publix Supermarkets	635	13.1
8	Delhaize America (Food Lion, Hannaford Bros.)	1,365	10.9
9	Meijer Inc.	130	9.5
10	Great Atlantic & Pacific Tea Co.	570	8.0
11	H.E. Butt Grocery Company	257	7.5
12	Supervalu[5]	345	6.6
13	Southland Corporation (7-Eleven)	n.a.	4.6
14	Shaw's Supermarkets	179	4.0
15	Pathmark Stores	135	3.7
16	Hy-Vee Food Stores, Inc.	247	3.5
17	Raley's	150	3.0
18	Aldi USA, Inc.	475	2.8
19	Wegman's Food Markets	57	2.5
20	Grand Union	221	2.3

n.a. = Not applicable.
[1]Sales by U.S. grocery stores, only. Excludes sales by other business units, foreign sales, and franchised sales.
[2]Excludes sales of drugstores.
[3]Includes sales of Randall's Supermarkets, acquired September 1999.
[4]Sales of food and nonfood grocery items only.
[5]Excludes sales other than company-owned grocery stores.
Sources: USDA-ERS estimates and company annual reports.

Figure 1
The Pacific Region Led the Way in Number and Sales of Acquired Grocery Stores...

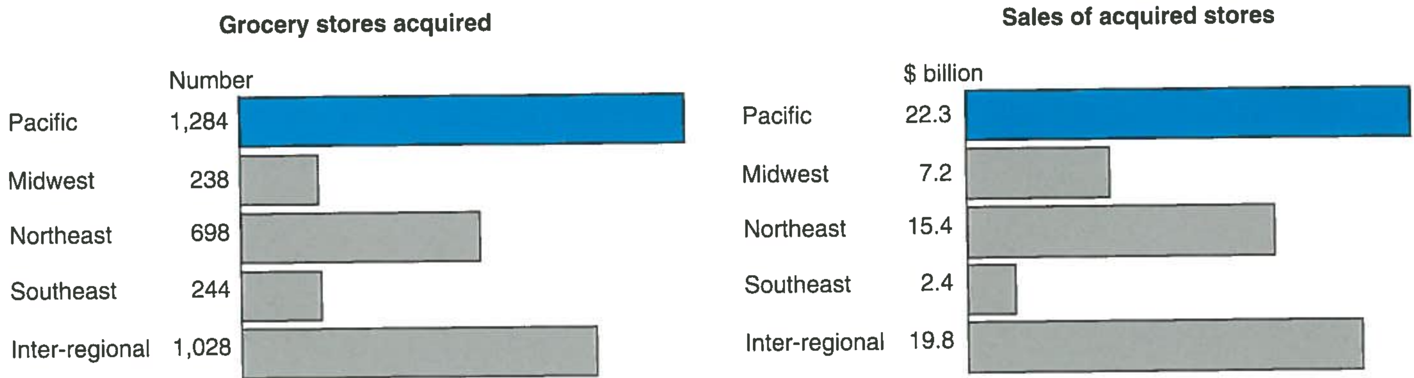


Table 2
...As the Nation's Largest Grocery Retailers Maintained Their Leading Positions and Grew by Merging

Acquiring and acquired retailer	Grocery stores acquired	Sales of acquired stores
	Number	*Million dollars*
Pacific Region:		
Safeway - Vons, 1997	325	5,400
Yucaipa - Fred Meyer, 1997	101	3,124
Quality Foods Centers - Hughes, 1997	57	1,250
Yucaipa - Smiths Food & Drug, 1997	150	3,000
Yucaipa - Quality Foods Centers, 1997	203	1,200
Albertson's - Lucky (American Stores), 1998	448	8,295
Midwest Region:		
Giant Eagle - Riser Foods, 1997	56	4,000[2]
Lund's - Byerly's, 1997	11	65
Albertson's - Jewel/Osco (American Stores), 1998	171	3,166
Northeast Region:		
Ahold - Stop & Shop, 1996	189	4,400
Ahold - Giant Food, Inc., 1998	176	4,200
Albertson's - Acme (American Stores), 1998	183	3,388
Food Lion - Hannaford, 1999	150	3,400
Southeast Region:		
Food Lion - Kash & Karry (Florida), 1997	100	1,000
Jitney Jungle - Delchamps, 1997	118	1,300
Kohlberg & Co. - Schwegmann's, 1997	26	115
Inter-regional:		
Safeway - Dominicks, 1998	112	2,300
Kroger - Yucaipa/Fred Meyer, 1999	800	15,000
Safeway - Randalls, 1999	116	2,500

[1]Total sales of American Stores (Lucky, Jewel/Osco, and Acme) was $19.9 billion in 1998. Sales by region exclude sales of 773 pharmacy/drugstores.
[2]Sales include wholesale sales to 586 independent grocery retailers.
Sources: Company annual reports, *Wall Street Journal* (various issues), *Supermarket News* (various issues), and *Food Institute Weekly Digest* (various issues).

acquisitions have always been a part of the food retailing industry, they were mostly on a smaller scale, involving a local or regional retailer. The large company combinations that have taken place since 1996 are unprecedented.

Supermarkets Debut in the 1930's

Mergers, acquisitions, and divestitures have always played a role in the changing structure of food retailing. During the 1920's, multi-store grocery chains, such as Kroger and A&P, expanded rapidly both by building new stores and acquiring others. The supermarket revolution began in the 1930's when single-store retailers introduced self-service, multi-department supermarkets. As their numbers grew, the procurement and selling efficiencies of supermarkets led grocery chain retailers to sell many of their smaller stores. By the 1950's, the chain retailers' transition to supermarkets was complete. Subsequent growth of large supermarket chains was accomplished through building new stores and through mergers and acquisitions.

Beginning in the mid-1980's, there was a wave of restructuring among many food retailers. These mergers involved "leveraged buyouts" in which an investor group would offer to purchase all outstanding stock of a publicly held grocery retailer, typically through the issuance of high-risk, high-yield debt often called "junk bonds." These private investor groups believed that after the purchase, a company would be worth more if the less profitable parts of the company were divested while maintaining the more profitable operations as a private company. As a result, leveraged buyouts often created smaller retailers through divestitures. The leveraged buyout of Safeway Stores, Inc., in 1986 began a series of often-controversial private investor buyouts of many publicly owned retailers, including Southland Corporation (7-Eleven), Supermarkets General Corporation (Pathmark), and Grand Union.

By the early 1990's, the leveraged buyout wave had ended. Some firms, such as Safeway, took steps to become public once again by issuing stock for sale to the public. Some grocery retailers grew by building new supermarkets or acquiring grocery stores, on a modest scale, from smaller firms to achieve sales growth. During the 1990's, the frequency of mergers and acquisitions fell as retailers focused on improving financial performance and reducing long-term debt. The blockbuster combinations in recent years are relatively few in number, but are large when measured by the number of stores involved, and by their effect on increases in the share of U.S. grocery store sales accounted for by the 4, 8, and 20 largest firms (fig. 2).

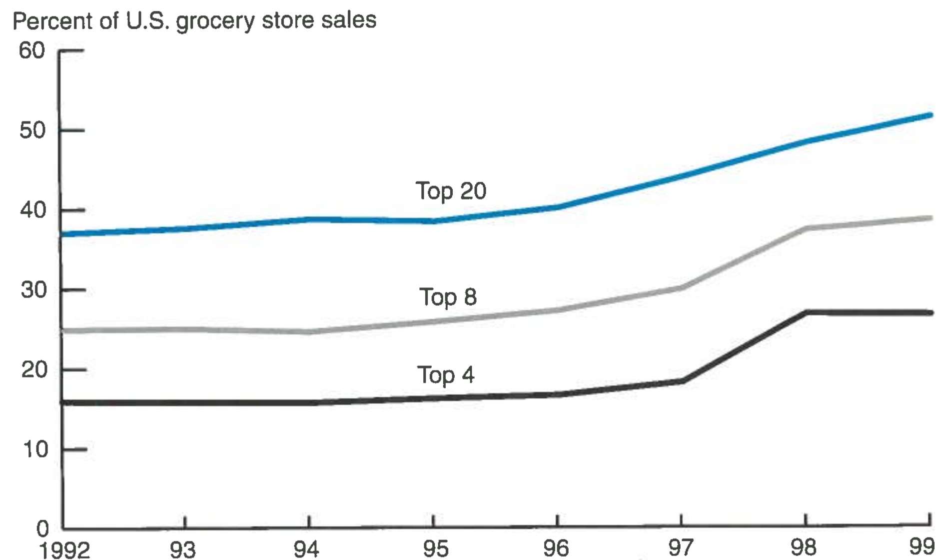
Retailers Face Slow Spending Growth and Higher Costs

The effect of slowing growth in real grocery store sales (net sales growth after adjusting for inflation) and competition from nontraditional retailer rivals is motivating grocery retailers to become larger.

Food retailing is a relatively slow-growth industry, typically expanding with increases in population, about 1 percent per year, on average. In the 1989-99 decade, real grocery store sales were relatively flat, averaging 0.2 percent annually. This small growth is likely the result of greater spending for food away from home and sales lost to other retailers selling food. The share of consumers' disposable income—income after taxes—spent on food sold in retail stores (food at home) has fallen from 7.1 to 6.3 percent over this same period. As incomes rose, consumers purchased more prepared foods and meals away from home. Of total spending for food, consumers spent 47 percent on meals and snacks in restaurants, fast

Figure 2

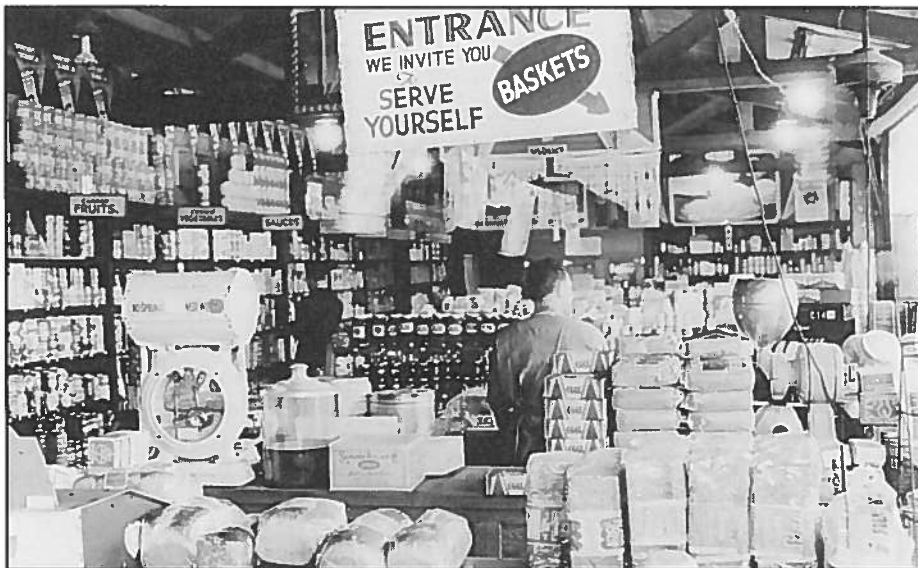
The 20 Largest Food Retailers Captured 51 Percent of the Nation's Grocery Store Sales in 1999



food places, and other foodservice establishments in 1998 compared with 45 percent in 1988, continuing a long-term trend.

In the 1980's, new store formats were developed to better address the needs of specific consumer segments, ranging from warehouse stores serving economy-minded shoppers, to organic and natural foods supermarkets aimed at less price-conscious, but health-oriented consumers. Nontraditional discount retailers such as mass-merchandisers and warehouse club store operators expanded their array of grocery products as well. Mass-merchandisers introduced the supercenter format containing a supermarket within a larger general merchandise department store. Warehouse club stores greatly expanded their grocery and perishable food offerings in order to expand their appeal to traditional supermarket shoppers and increase shopping frequency.

The growth of discount mass-merchandisers and warehouse club stores has likely provided additional sources of competition for food retailers. Mass-merchandisers, such as Wal-Mart, Kmart, and Target, and warehouse club operators, such as Costco, Sam's (a division of Wal-Mart), and BJ's, have increased their share of retail food sales from 2.8 percent in 1988 to 8.1 percent in 1998. In contrast, supermarkets' share of food sales fell from 65.8 percent in 1988 to 60.3 percent in 1998. Convenience stores, other grocery stores, specialized food stores, and other retail stores accounted for the remaining sales shares.



The supermarket revolution began in the 1930's, when single-store, independent grocery stores invited their customers to take a basket and "serve yourself."

Credit: Archives of the Food Marketing Institute.

Today, discount mass merchandisers, such as Wal-Mart, and warehouse club operators have expanded their grocery product offerings and are cutting into supermarkets' sales. The share of retail food sales accounted for by these discount retailers grew from 2.8 percent in 1988 to 8.1 percent in 1998.

Credit: Ken Hammond, USDA.

To compete with fast food eateries, as well as to address time-pressured shoppers' need for convenience, salad bars and prepared foods were introduced by grocery retailers. Although many supermarkets of the 1980's had a service meat counter offering sliced-to-order items, few offered prepared hot or heat-and-serve items. By 1997, fully 83.6 percent of supermarkets sold prepared foods, including sandwiches, pizzas, and pasta dishes, accounting for 4 percent of store sales, on average.

The produce department has changed dramatically through the provision of year-round varieties, pre-cut produce, and more packaged and branded products of higher quality. From 1987 to 1997, the number of different items sold in the supermarket produce department nearly doubled, from about 173 to 335, on average (see "Evolving Marketing Channels Reveal Dynamic U.S. Produce Industry" elsewhere in this issue). With the growing popularity of the Internet in the mid-1990's, a number of retailers introduced at-home shopping and delivery services, raising shopping convenience to new levels.

Food retailers have responded to changing consumer tastes and preferences through diverse store for-

mats and expanded product offerings and store services, despite their often higher costs. As a result, a number of grocery retailers have pursued mergers and acquisitions seeking efficiency gains in order to offset the higher costs of providing consumers with the variety and services they want.

Efficiency Gains and High Construction Costs Encourage Consolidation

Food retailers involved in recent mergers and acquisitions have cited potential lower costs and efficiency gains as primary benefits of consolidation. These retailers believe they can lower their procurement, marketing, and distribution costs if they increase in size. The retailers hope these lower costs will allow them to maintain their profitability while keeping prices competitive with mass-merchandiser and warehouse-club rivals.

To lower operating costs, consolidating grocery retailers are centralizing management and control at headquarters. New information technologies, such as companywide satellite and Internet communications and store checkout scanner data, allow for centralization of many management activities that previously were the responsibility of store-level managers. The availability of timely and detailed information at headquarters also allows for effective control of operations over relatively large geographic areas.

Food retailers also cite greater efficiencies in the procurement of retail products as a benefit of consolidation. Food retailers hope to lower per unit cost of goods by negotiating with suppliers and distributors for lower wholesale prices on large orders. In return, retailers are able to offer exclusive procurement agreements such as partnering, long-term agreements, and other strategic alliances that offer potential benefits to suppliers and distributors. Retailers also gain a more reliable source of supply, and, over time, can work to develop higher quality and more uniform food products, very important for many perishables such as produce, meat, and prepared foods.

Large supermarket chains are also asking suppliers and distributors to provide additional marketing services that formerly were the responsibility of retailers. These marketing services include designing and providing category management activities, in which the mix of items sold are determined both by their sales and by distribution and in-store costs associated with the item; supplying in-store promotion and point-of-purchase promotional materials, such as special displays and shelf-based coupon dispensers; planning and advertising sales events; and providing special packaging, such as multiple-item packs or special package sizes. Retailers may also share checkout scanner data with suppliers and distributors to better evaluate how consumers respond to promotions, advertising campaigns, and price changes. By working closely with their suppliers and distributors, retailers can reduce marketing costs while improving the effectiveness of store-level marketing activities.

Large retailers also cite potential cost savings through streamlining product distribution functions. Large grocery chains typically perform wholesaling activities such as purchasing goods from suppliers, arranging for shipment to distribution warehouses, and replenishing store-level inventory. Supply-chain management practices such as continuous inventory replenishment (a method by which more frequent deliveries by suppliers reduce storage and inventory costs of the retailer), the use of cross-docking facilities (where single-load truck shipments from suppliers are transferred directly to mixed-load trucks for shipment to stores, eliminating the need for warehousing), direct store delivery to supermarkets by suppliers, and selective use of specialized wholesalers can reduce the need for large retailer-operated distribution centers and their associated costs.

Another factor contributing to growth through mergers and acquisitions concerns the greater capital expenditure requirements of building new stores compared with the purchase of existing stores. Today's larger supermarkets and supercenters call for much higher sales volume in order to achieve profitability. As long as 2 years may be required to develop sufficient sales volume to achieve positive store profitability, whereas most existing stores have already reached minimum sales requirements. As a result, the financial risk of building a new store is often greater than purchasing an existing store.

Consolidation's Effect Varies

Grocery retailers are consolidating to ensure their long-term success in response to competitive forces. Trends in consumer spending and the growth of nontraditional retailers are likely to continue. Whether expected benefits to consolidating retailers will be realized has yet to be determined. Over time, analyses of profitability, sales growth, and operating costs will show whether these large retailers have benefited from consolidation. Smaller retailers also may adopt supply-chain management practices to gain efficiencies as an alternative to becoming part of a larger company.

Concerns have been raised about sufficient competition as grocery retailers become larger in size but fewer in number. One safeguard is the role of Federal antitrust agencies that review mergers and acquisitions for their impact in the local areas such as cities and towns where retailers compete. Regulators may require the sale of one or more of the firms' retail outlets to another competitor in order to preserve competition in the affected local market area. For example, antitrust regulators required Albertson's and American Stores to sell 144 supermarkets operating in 57 local markets in California, Nevada, and New Mexico before approving the merger of these two grocery retailers. Regulators determined that the merger as proposed would substantially lessen supermarket competition, and higher prices, or reduced quality and selection for consumers could result in those local markets.

Consolidation may have the greatest impact on grocery suppliers, such as wholesalers and manufacturers and farmers. As more grocery retailers pursue supply-chain management practices, suppliers will be asked to perform more retail support activities, such as marketing and promotion. Suppliers must be willing to develop these capabilities through employee training and adopting new technologies. Small grocery suppliers may conclude that by forming alliances, such as joint ventures, cooperatives, or even mergers, they are better able to meet the procurement and marketing needs of large retailers. Other suppliers may concentrate in a niche market, such as specialty fruits and vegetables or organically grown foods, to have the capability to meet the procurement needs of all sizes of retailers.

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