TRENDS IN FOOD MARKETING IN THE UNITED STATES

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This article discusses some major trends in food marketing in the United States, as revealed in a detailed study of food distribution undertaken by the National Commission on Food Marketing. Attention is focused on the growing industrialization of farming and the consequent decline in terminal auction markets; the increasing role of new product development in ensuring profitability of food processors. Trends in the food retailing industry are also discussed and compared with conditions prevailing in Australia.

Food marketing trends in the United States are of interest partly for their own sake and partly because they may foreshadow changes in food marketing in Australia. Many major American food processors and retailers operate in Australia, for instance H. J. Heinz, Kellogg, Nabisco, Campbell's Soups and Safeways to mention but a few. Many American firms in Australia introduce new techniques and products after they have been successful in the United States. Again in many areas of food processing and technology the United States is one of the major if not *the* major innovator. Lastly, as our standard of living rises and consequently our real wages approach those now current in the United States, it will often pay us to adopt similar labour saving techniques.

The United States has just had a very large scale enquiry into food marketing which provides a good opportunity to survey current trends and future prospects there. This Enquiry was undertaken by the National Commission on Food Marketing, a 15 member commission created by Congress in 1964. While 10 of the 15 members were Senators or Congressional representatives, the Commission assembled a large staff of professional research workers under the leadership of Dr. George Brandow, a former President of the U.S. Farm Economics Association. Apart from the main Report the Commission issued 10 Technical Studies and 12 supplements, a total of about 3,800 pages.[1] These bring

[1] Food from Farmer to Consumer, Report of the National Commission on Food Marketing, U.S. Government Printing Office, Washington, D.C., June 1966. The titles of the Technical Studies are:

No. 1 Organization and Competition in the Livestock and Meat Industry.
No. 2 Organization and Competition in the Poultry and Egg Industries.
No. 3 Organization and Competition in the Dairy Industry.
No. 4 Organization and Competition in the Fruit and Vegetable Industry.
No. 5 Organization and Competition in the Milling and Baking Industries.
No. 6 Studies in Organization and Competition in Grocery Manufacturing.
No. 7 Organization and Competition in Food Retailing.
No. 8 The Structure of Food Manufacturing.
No. 9 Cost Components of Farm-Retail Price Spreads for Foods.
No. 10 Special Studies in Food Marketing.

- Private label products in food retailing.
- Retail food prices in low and higher income areas.
- Notes on economic regulation.

together the most complete account yet given of the food marketing system in the United States.

There were two main reasons for this searching enquiry:

1. There was widespread criticism of the large and growing spread between the prices consumers pay and the prices farmers receive. It was widely supposed that this price spread might be drastically reduced with benefits to both producers and consumers. In particular there was concern because the decline in beef prices in 1964 had apparently been swallowed up by a rise in the farm/retail price spread for beef. This specific allegation turned out to be incorrect and traceable to statistical shortcomings of the Bureau of Labor Statistics retail price series. The series did not reflect adequately the existence of price specials or the pattern of food purchases during the different days of the week. As far as I could ascertain, the Australian consumer price index contains at least some of the same statistical shortcomings which would allow a similar type of error to occur in this country.[2]
2. In addition there were more general charges of growing concentration in food processing and retailing. Radicals claimed that the excessive market power of the large corporations led to excess profits. Conservatives argued that profits were not high but, even if they were, this reflected efficiency rather than monopoly gains.

Needless to say, neither group managed to completely convince the other; in the end the Commission was split into a majority and a number of minorities. While the factual investigations of the professional staff managed to narrow the area of disagreement, the emotional positions of elderly politicians cannot easily be eroded by facts. In this case agreement was perhaps especially difficult as there was factual support for some conservative tenets and for some radical tenets. I will concern myself with the major trends in U.S. food marketing rather than the desirability of legislation, the major subject of disagreement among the Commission members. I have summarized elsewhere what I believe to be the most important changes in the marketing of the different products.[3] Here I want to confine myself to a broader picture. I shall mention briefly some of the major trends which are common to a number of commodities. This will be followed by a more detailed discussion of developments in food retailing, including some comparisons of conditions in the United States and Australia.

Growing Industrialization of Farming

One interesting trend is the growing industrialization of farming. By this I mean that more and more farming operations are taking on an industrial character with man gaining much greater control over the results of his efforts than is possible in traditional agriculture. Greater control increases the possible benefits which can be derived from more centralized management. In an increasing number of farming industries

[2] However since we do not normally publish farm-retail price spreads, the danger of such mistakes is perhaps somewhat smaller in Australia. The statistical points are discussed in Technical Study No. 9, pp. 4-5.

[3] Gruen, F. H., "Food Marketing in the United States: A Review Article", *Review of Marketing and Agricultural Economics*, 36 (2), June 1968.

many of the normal farming decisions are no longer made by the actual operator of the farm. Decisions such as what rations to feed, what breeding programmes to adopt, what fertilizer to apply, when to buy and when to sell are being made increasingly by such outside agencies as feed manufacturers, slaughter houses or processors of fruit and vegetables.

In the irrigated fruit and truck crop operations in California the industrialized nature of farming has been recognized for many years. Within the last decade, broiler production has become organized on a system of central management even though ownership is not centralized to the same extent. Similar trends are operating in turkey and egg production. Within five years most eggs and turkeys will probably be produced by farmers under contract to feed manufacturers or slaughter houses. Again fruit and vegetables processors tend, increasingly, to specify the type of farming operations to be followed by their suppliers. An industry where industrialized farming of this kind is still in its infancy but growing quite rapidly is cattle fattening in feed lots. Large feed lots have been able to achieve substantial economies of size. Owners of such feed lots often custom or contract feed for meat buyers, packers and others. In addition some 15 to 20 per cent of total feed lot capacity is owned by meat packers, or other buyers such as chain stores.

The Decline in Terminal Auction Markets

The growth of large scale ownership of decision making units reduces the need for the traditional terminal auction markets where produce is sold by the farmer's agent to the processor, wholesaler or retailer. Such markets are increasingly by-passed either by long-term contractual arrangements between growers and processors or by direct shipment of produce to the processor, the ultimate retailer or his agent. Long-term contractual arrangements between processors and growers have become, or are becoming, the predominant method of sale for broilers, turkeys and for fruit and vegetables grown primarily for further processing. Direct shipping to customers has become of growing importance for cattle, sheep, pigs, fresh fruit and vegetables. For instance in 1940, 75 per cent of all cattle used to be sold through terminal auction markets. Twenty-five years later this had shrunk to 35 per cent.

The reasons for the by-passing of auction markets differ to some extent from one product to the other, but the reduction of distribution costs achieved is an important factor in each case. This is certainly the most important reason why chain stores purchase practically all their fruit and vegetable requirements directly through shippers in country centres.

The decline of terminal auction markets raises some problems. Ascertaining the prices at which products change hands becomes more difficult when auction prices become representative of a smaller and smaller percentage of the total trade. In some cases they may disappear altogether even though the need for price information of all interested parties becomes greater. Processors are if anything more concerned about the prices at which they buy because they can now be less certain of the prices paid by their competitors. Farmers can no longer rely on the market for obtaining the best prices possible. Bargaining becomes more important. This requires more knowledge of alternative outlets and of prices paid in other areas. Farmers are frequently less knowledgeable than processors about market price. Hence they will often be at a disadvantage in any direct bargaining with brokers or processors. This disadvantage can be reduced if they are backed by a very comprehensive and up-to-date public system of price information. This does not exist at the moment either in the United States or in Australia. To cope with this problem the National Commission on Food Marketing recommended that firms buying and selling farm products be required to report both prices and quantities to the relevant public marketing authority. At present chain stores and other large buyers treat their purchase prices and the quantities they buy as closely guarded trade secrets. Confidential reporting of such transactions to public authorities would enable the publication of more adequate price series. With the rapid growth of production under contract in Australia and the increasing gains made by groups and chains in selling fruit and vegetables, the need for improved price information has been accentuated.

The Profitability of Food Marketing

The overall profitability of food manufacturing in the U.S.A. has been a little below the average for all manufacturing operations. But these averages conceal a considerable dispersion between industries. The processing of what might be called commodities, i.e., the large group of basic foodstuffs is intensely competitive, with profitability usually fairly low (10 per cent of net worth or less). Meat packing, the processing of dairy products, flour milling, bread baking, the canning and freezing of fruit and vegetables are some examples of food manufacturing industries where product differentiation is comparatively minor and where profits tend to be low. Profits tend to be higher in industries producing highly processed and differentiated products such as cereals, TV dinners, coffee creamers, baby foods, biscuits, pet foods, packaged desserts and soft drinks.

Broad segments of the consuming public in the U.S. have become sufficiently affluent to willingly pay substantially higher prices for both convenience and variety. Coupled with this change in the market, large grocery manufacturers are concentrating their major efforts on developing and marketing new products. Business success depends increasingly on the ability to develop new, or at least slightly different products and on the firm's persuasive powers that its products are uniquely desirable.

New product introduction is costly. Research and development costs averaged about $70,000 per product, marketing research averaged $25,000 while test marketing cost about $250,000 for each new product, making a total of $350,000 per product. Though, one should add, not every product passes through all three stages. Nevertheless it is obvious that expenditure of this magnitude will only be undertaken by reasonably large firms, especially since, in spite of market research and test marketing, the risks of failure remain substantial. About one-fifth of the product innovations examined were discontinued after test marketing and a further one-fifth of the remaining products were discontinued within three years.

On balance, it seems likely that such innovative activity is highly profitable. Thus the large firms able to undertake research and development and market management are increasing their expenditure on these activities at a rapid rate. Research and development expenditure, while low by comparison with other industries, has doubled in the last ten years and market research expenditures have almost trebled.

In some instances the high profits realized from innovation and new product introduction appeared to be neutralized reasonably promptly. Thus rates of return in the processing of broilers and of frozen orange juice, both originally highly profitable activities, have been lowered to the level of the "basic" commodities referred to earlier. On the other hand, leading cereal producers have managed to obtain rates of return of almost 20 per cent on net worth for many years now. There is little evidence that profitability in this industry is being eroded by new entrants or by pressure from retailers.

Food Retailing

Retailers have employed two main techniques to limit manufacturers' profit margins; first, actual or threatened vertical integration into processing and second, the use of private, retailers' brands, produced in their own plants or obtained under contract from manufacturers willing to produce on this basis. Both vertical integration and private branding have increased in the post-war period. This growth is not only designed to counter the power of oligopolistic supply industries. The achievement of selling and distribution economies is frequently an important reason. Both vertical integration and private branding tend to improve the distributing system, by reducing costs and by weakening any monopoly power of processors.

Other features of American food retailing which I should mention include:

1. Grocery stores are responsible for practically all retail food sales (92%); sales of specialty stores having declined from 24 per cent of total retail food purchases in 1939 to less than 8 per cent in 1963. In Australia specialty shops, especially butchers and fruit shops, are relatively more important. Grocers here account for somewhat less than 60 per cent of all food retail sales.[4]

   Not surprisingly American food stores are considerably larger than ours, both in terms of value of sales per store and probably in area. Thus in 1962 Australian grocers with annual sales of half a million Australian dollars accounted for 14 per cent of total grocery sales, while in the United States, in 1963, stores with annual sales of one million U.S. dollars accounted for over half of all food sales.

   In 1948 total United States grocery store sales were divided into three roughly equal parts, sales by chains, by independents affiliated into groups and by unaffiliated independents. Fifteen years later chains and groups accounted for about 45 per cent each, while unaffiliated independents had virtually disappeared (9%). In Australia unaffiliated independents would account for a larger proportion of food sales though exact figures are not made

[4] Briggs, D. H., and Smyth, R. L., *The Distribution of Groceries*, University of Western Australia Press, 1967, pp. 7-11.

available by the Statistician.[5] Small and intermediate size chains have been largely responsible for the growing proportion of food sales by chains in the United States; the top twenty chains having made little progress in their relative share in recent years.

2. With the growing proportion of sales made by chains and groups the buying of food has become more concentrated. In 1948 the seventy largest chains and group wholesalers accounted for 32 per cent of all food store sales; by 1963 this percentage had risen to 52. For those products where national as opposed to local markets are relevant, this is hardly a dangerous level of concentration. Even if 70 buyers account for half of all purchases, any single processor must have literally dozens of potential alternative buyers.

   At the local level concentration has also increased and is of greater significance. In the average metropolitan area the market share of the four largest retailers has increased from 45 per cent in 1954 to 50 per cent in 1963. This has affected the number of alternative buyers for processors who operate only in local markets such as bakers and milk handlers.

3. The Commission made a very thorough statistical study of the margins obtained by retailers. The most important factors influencing the profitability of retail stores were the degree of store utilization or sale per square foot and the size of store. There was no evidence that high market shares in a locality led to high prices or to high margins. In other words there was no evidence that increasing concentration has enabled retailers to extract either lower prices from suppliers or higher prices from consumers. An interesting feature of the statistics was the difficulty experienced by retailers in maintaining local market shares of 25 per cent or more. Prominent market positions of this magnitude appeared to be subject to considerable erosion over a period of 5 years or so.[6] Some reasons were suggested for this phenomenon. It was argued that most retailers who are successful "have an aggressive promotion policy, i.e., they develop an image. They are the 'low price' people, the 'quality' people, the 'friendly' people, etc. While this image strikes a harmonious chord with a part of the consuming population and will help firm growth to a point, the population of consumers is so diverse that no image is harmonious to all. After a point is reached, the image which assisted early growth may retard further expansion."[7]

4. The distribution economies originally achieved by chains have now been copied by all important units in the retailing system. As a result the cost advantage of chains has largely disappeared.

[5] *Ibid.*, pages 19 and 60. According to "Retail World" (Dec. 13, 1967), the trade magazine of retail grocers in Australia, chains accounted for 37% of the grocery business in 1963, groups for 29½% and independents for 33½%. By 1967 their relative shares were 47·4, 37·3 and 15·3% respectively.

[6] Cf. Technical Study No. 7, pp. 54-55. Thus of 21 retailers who had achieved shares of 25 per cent or more in various local markets by 1954, 11 had moved into the 20-25 per cent category (or a lower one) by 1958. Of the 24 firms with shares of 25 per cent or more in 1958, 17 had moved into a lower category by 1963.

[7] Technical Study No. 7, p. 57.

This has led to the growth of non-price competition since the mid-1950s. Early forms of non-price competition consisted largely of improved services including the stocking of a larger variety of goods and the provision of longer shopping hours. More recently competition has taken forms completely unrelated to normal retailing functions. These include the free provision of trading stamps, of games of chance with sizeable money prizes, and of similar promotional gimmicks. The early adoption of new forms of non-price competition can be remarkably effective in building up store volume and thus profitability. In at least one case the evidence suggests that an attempt to meet non-price competition "head-on with price reductions" was too costly even for the second largest chain in the United States.[8]

The majority of the Commission were critical of promotional gimmicks and felt that in many cases selling expenses had been raised too much. Expenditure on promotion could be reduced, they believe, without impairing the value of the final product to the consumer. The quality of life in the United States, it seems to me, is not improved by such bamboozling of the consumer and the occasional piece of deception one encounters. Thus, according to the National Commission on Food Marketing, about one so-called price special in every seven which was advertised by the major food chains turned out not to be a price reduction at all. While any society which holds to the principle of *caveat emptor* encourages this type of deception, I formed the impression that it is perhaps somewhat more frequent in the United States than elsewhere.

In a free society there is a limit to the level such abuses can reach. The increased expenditure on non-price competition has produced an economic opening for food discounters, food stores stressing price competition and operating on low margins. The advertising and promotion expenses of food discounters are about half of those of chain stores, their gross margins are about 25 per cent lower and their retail prices about 4 per cent lower. They are a comparatively recent development, having first appeared on the scene in the late 1950s. By 1965 they accounted for over 10 per cent of the grocery store business.

Finally, the National Commission on Food Marketing investigated the assertion that food retailers charge higher prices in low income areas. The general conclusion was that there were no significant differences in prices charged *in the same type of stores* in low as compared

[8] The case concerned the attempt in the mid fifties of Safeway to combat the introduction of trading stamps by means of price competition. The company was successfully prosecuted under various types of anti-trust legislation for seeking to wipe out opposition. However, what concerns us here is not the illegality of the action (or the wisdom of the legislation) but the relative ineffectiveness of price competition against a new type of promotional device such as trading stamps. According to a statement by Safeway stores before the N.C.F.M. in May 1965, "Safeway's cost structure would not support meeting all competitive challenge head on with price reductions". At the same time, Safeway's return on net worth dropped to about half the average level of its competitors. In the five years following a change of policy and management (in late 1955) it returned to the normal industry average.

to high income areas. However, food prices are higher in the small independent stores which are relatively more common in low as compared to high income areas. Thus, "the problems of the poor are compounded by the fact that they comprise a high-cost market. Families in low income areas have gained least from modern food distribution. . ."[9]

Much more effort and ingenuity enters into the provisions of new flavours, better packages and more convenience for the affluent middle class consumer than in finding cheap and novel ways of catering for the less advantaged members of the society. This is perhaps the most fundamental criticism which can be made of American food marketing. But this criticism can hardly be confined to food marketing or to America.

[9] N.C.F.M. Report, p. 81. The most detailed discussion of the results of this study are given in Technical Study No. 10, pp. 122-144.