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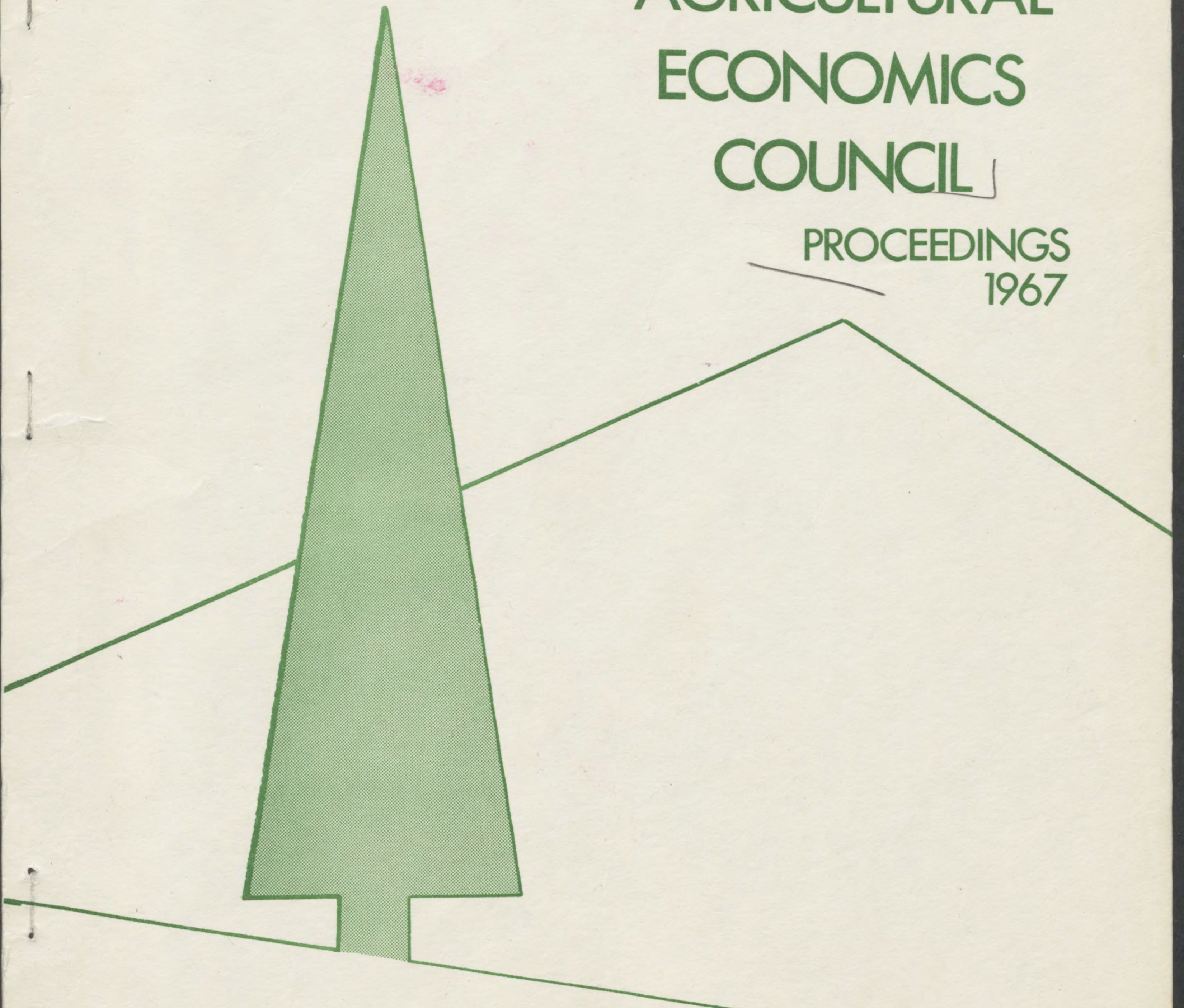

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CHANGES IN THE WHOLESALE AND RETAIL STRUCTURE IN FOOD MARKETING IN THE NORTHEAST

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It is always difficult to follow a feature attraction, and this is especially true in my case here today. My assigned task is to discuss, on a smaller scale, what the National Food Marketing Commission, under Dr. Brandow's guidance has documented so adequately on a national basis. As one might expect, the changes in the market structure of food wholesaling in the Northeast have, in general, paralleled the changes in the nation as a whole.* Therefore, there is no reason to repeat all of the details concerning changes in the number and size of firms and conditions of entry for food wholesaling and retailing firms in New England and the U.S.

So I have decided to exercise poetic license and take some liberties with the assigned topic. First of all, I will add behavior and performance to structure because structure is meaningful only when related to the other components of industrial organization.

Secondly, I will attempt to identify changes which have occurred in food wholesaling and retailing in the Northeast and especially in New England which I consider to be of particular significance or which differ from those changes which have occurred nationally.

And finally, I will prognosticate about changes and developments in food distribution and their implications.

First let me say that I am not going to take issue with the National Commission on Food Marketing Reports, particularly Technical Study No. 7, <u>Organization and Competition in Food Retailing</u>. This is not to say that I agree whole-heartedly with all of the conslusions and recommendations of the Commission majority, because that is not the case. But I believe that to critize the conclusions and recommendations per se misses the point - that the real value of the Commission's work was the painstaking documentation of what has happened, and in many cases, why. Of course there will be disagreement concerning what should be and how to achieve it as long as people have different value systems and until we can correlate market structure, behavior and performance in the food industry with a greater degree of certainty than is now possible. But the work of the Commission has brought the areas of disagreement into sharper focus and has provided economic researchers and teachers with an excellent body of data which was not available previously.

My remarks will be based upon statistical data from the National Commission on Food Marketing, other government sources, university reports and studies, trade sources and my own personal observations and evaluation.

Market structure

As in the nation as a whole, the number of grocery stores declined while grocery store sales increased in New England since 1948. The decline in store numbers was relatively greater in New England than in the United States from 1948 to 1963.

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*The Northeast refers to the six New England States plus New York, New Jersey and Pennsylvania.

Total grocery store sales increased somewhat less in New England than in the U. S. but sales per store increased at a faster rate in New England than in the U. S. during the 1948-1963 period. Sales per store were about 20% greater in New England than the U. S. average. This was due primarily to the relatively high per store sales in Connecticut and Massachusetts.

The National Commission concluded that concentration is increasing in food retailing at the local level based upon an analysis of market shares of the largest retailing firms in 218 standard metropolitan statistical areas throughout the U. S. for 1954, 1958 and 1963. A comparison of nine SMSA's in New England with the average of the 218 SMSA's indicates that the trend towards increased concentration is similar in both New England and the U. S. However, the degree of concentration appears to be somewhat less in most of the nine New England SMSA's than in the U. S. generally. This is particularly true in the Boston and Worcester metropolitan areas.

The market shares of the largest four and largest eight firms in 1963 were similar in both Boston and the U. S. generally, but the market share of the largest 20 firms was considerably less in Boston than the U. S. average. In fact, the market share of the largest 20 firms in Boston declined by more than 10 percentage points from 1954 to 1963 while it increased by about 10 percentage points in the U. S. during the same period. This comparison reflects the fact that there are a large number of aggressive, single and multi-unit firms operating in the Boston market. The growth of these firms has been largely at the expense of A and P and First National, the former leaders in the Boston market whose positions have deteriorated rather dramatically during the past 10 years. Thus, the Boston market has become more fragmented compared with most metropolitan areas in the nation.

The Worcester, Massachusetts market presents a unique food marketing situation. It has one of the lowest levels of concentration in food retailing of any of the large metropolitan areas in the United States. The four largest firms accounted for only 27 percent of the total grocery store sales in 1963 compared with more than 50 percent for the largest four firms in the average SMSA in the U. S. The shares of market held by the eight largest and 20 largest firms in Worcester were also much lower than the U. S. averages. The large national and regional corporate chains have never been able to penetrate the Worcester market to any appreciable extent. Several local, independent multi-unit and single unit firms have been able to gain and hold the initiative in this market. Strong leadership on the part of independent wholesalers has been instrumental in the success of independent retailers in the Worcester market.

The structure of food retailing in northern New England is characterized by relatively high concentration in the cities and a low degree of concentration in the rural areas and small towns. A trade source reports that the overall share of market held by food chains declined from 43.3% to 39.3% from 1963 to 1965 in Maine, New Hampshire and Vermont.[1/] This is not surprising inasmuch as the corporate chains tend to avoid building supermarkets in areas which are sparsely populated and are still in the process of closing old, outmoded stores in rural communities.

The decline in grocery store numbers has been accompanied by a corresponding demise in the number of general-line grocery wholesalers. The multi-story, inefficient grocery warehouse could not survive and most of those who did not adapt departed the scene. Although physical efficiency was vital to the economic survival

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1/ Yankee Grocer, Shamie Publishing Company, Inc., Boston, Massachusetts, August 1966.

of the wholesaler, equally as important was the ability to provide a complete line of merchandise and specialized services equivalent to the "package" of the integrated, corporate chain. The role of the independent wholesaler in the growth and development of single and multi-unit independent retailers cannot be overemphasized. Here in New England as well as in other parts of the country, efficient, progressive wholesalers have enabled retailers to purchase merchandise competitively and have provided the retailer with a wide range of management services. Of particular significance is the site selection research provided by the wholesalers. This service, together with various types of financial assistance, has been instrumental in overcoming barriers to entry which probably would have resulted in restricted growth of independent retailers and even greater market concentration than exists currently.

Behavior and performance

There are several aspects of behavior and performance in food retailing in the Northeast which, in my opinion, are worthy of special attention.

Starting with performance it is apparent that Northeastern food retailing firms have engaged more heavily in advertising and promotional activities than their counterparts in other areas of the country. Available data indicate that advertising and promotional expenses as a percentage of sales are highest in the Northeast. They also indicate that total operating expenses are higher only in the far West (because of the high labor cost on the West Coast) and that net operating profits are considerably lower in the Northeast than in any other region.2/ The reasons for the lower net profit rates of retailing firms in the Northeast are not clearly evident. Certainly the expense rates are an important contributing factor. Advertising and promotion expenditures are the highest of any region and labor expenses are higher only in the far West. Gross margins have not increased at the same rate as total expenses and declining net profit rates have resulted.

One possible explanation for relatively high operating expenses in relation to gross margins in the Northeast is that there is an increasing tendency for stores to operate below capacity due to greater market saturation.

Stores may be larger in the Northeast to the extent that relatively high sales volumes must be achieved in order to realize a satisfactory degree of utilization. The National Commission study concluded that store utilization, as measured by dollar sales per square foot of selling space, has a very significant effect on store costs.3/ It is apparent recently that the primary objective of some large firms is to increase sales volume per store even at the expense of short-run profits. The compelling desire for increased sales may well be a reflection of the current underutilization of food store facilities.

The "food at home" component of the Consumer Price Index shows that food prices in Boston have increased more than in other major cities during the past year.

2/ Figure Exchange Reports, 1954-1965, Super Market Institute, Chicago, Illinois and Operating Results of Food Chains, 1963-64, Wendell Earle and John Sheehan, Cornell University, Ithaca, New York.

3/ Organization and Competition in Food Retailing, Technical Study No. 7, National Commission on Food Marketing, June 1966.

There are also strong indications that the current level of food prices is higher in the Boston market than in most other cities.[4/] If food prices are higher in Boston then it stands to reason that they are also higher throughout most of New England because of the influence of Boston based firms and the Boston "market" in general.

What are the behavior characteristics associated with the performance just described? First of all, it is interesting to note that in spite of the relatively high promotional expense in the Northeast, fewer companies use trading stamps than in any other part of the country.[5/] Northeastern firms have resorted more to promotional giveaways. In my opinion the emphasis on non-price competition in the Northeast is due in large part to the saturation of market areas. Supermarket capacity, particularly in the metropolitan areas, has outrun population growth and supermarket firms have resorted to promotional activities to an increasing extent in order to maintain or regain market shares. I believe that this has been especially true in the New England metropolitan areas. I know of many large food stores in Massachusetts where the sales volume has dropped by 30 percent or more during the last five years.

A large regional chain, Stop and Shop, has signaled a return to more direct price competition by adopting a "discount program" and dropping trading stamps. The discounting appears to consist primarily of an overall reduction in the prices of non-perishable merchandise. It appears that Stop and Shop may be regaining the position of price leadership abdicated by A&P when that company adopted trading stamps.

An aggressive retailer-owned cooperative, Shop-Rite, is the generally acknowledged price leader in the New York and New Jersey markets. The members of this cooperative operate very large stores which achieve average sales in excess of $3 million annually. These operators stress extensive merchandise selections, private brands and price competition. The cooperative is now represented in parts of Massachusetts and Connecticut and further encroachment into the New England area could bring about more intensive price competition.

There doesn't appear to be any clear-cut reason why retail food prices are higher in New England than in other regions. Many reasons have been suggested including higher transportation costs, too much competition, too little competition and general economic conditions. I believe that additional study is needed to establish the differential, if any, which exists between food prices in New England and elsewhere and to identify the reasons for the differential.

In summary, food retailing in the Northeast in recent years has been characterized by relatively high advertising and promotional expenses and relatively low net profit rates. It appears as if there might be a trend towards greater price competition and away from non-price competition.

Aggressive single and multi-unit independent firms backed by efficient wholesale suppliers have been unusually important factors and have been partly responsible for less concentration in some major metropolitan areas in New England than is found in most metropolitan areas. Much of the growth of these firms has been at the expense of the large, corporate chains.

4/ Special Report on The Increasing Costs of the Necessaries of Life, Notably Foods, Massachusetts Consumers' Council, The Commonwealth of Massachusetts, February 1967.

5/ The Super Market Industry Speaks, 1966, Super Market Institute, Chicago, Illinois.

There are indications that food prices are higher in New England than in other regions, but the reasons are not clearly evident.

Food retailing in New England can be described as in a state of flux. Competitive strategies of major firms have undergone frequent shifts and it is not yet clear which combination of price and non-price competition will predominate.

Emerging issues

It seems to me that there are several developments and issues concerning food retailing and wholesaling that bear special significance for the future not only in New England but in the nation.

The trend towards greater standardization of food products, especially perishables, has some interesting implications for producers, distributors and consumers. It is apparent that retailers have been able to practice variable-markup pricing very effectively in the pricing of fresh meats and produce because of the variation in product quality both within and among firms. As products become more uniform and as preparation and packaging techniques become more highly standardized, the pricing of perishable merchandise will likely become more competitive. The result will likely be a reduction in the level of margins realized for perishables which will necessitate pricing adjustments for the entire merchandise line in order to maintain overall margin objectives. The pressure for greater uniformity will continue to be reflected back to producers who will need to increase their efforts to provide a dependable quantity of uniform product.

It will become increasingly difficult for individual producers in New England to sell directly to retail accounts as the trend towards standardization progresses. The pre-packaging of fresh fruits and vegetables is already at a more advanced stage in New England than in any other region. Pre-packaging of produce will continue to be shifted away from the retail level to complete service wholesalers, chain-owned facilities, custom packagers and grower-shippers.

The use of private labels or brands will continue to grow and may result in the demise of all but the most heavily advertised and economically strongest national brands. It is probable that chain and independent distributors will have to devote more attention to product research and development and quality control in relation to private branded merchandise. These commitments along with increased selling efforts are likely to reduce the price differentials between private and nationally advertised brands.

I believe that more serious attempts will be made on the part of the food industry to determine consumer characteristics, attitudes and preferences and their relationship to the acceptance of the products and services of firms. Sales prediction models are still in their infancy, but I believe that they will ultimately enable firms to predict the effects of changes in competitive strategy with sufficient accuracy to replace management estimates or intuition. This will result in greater responsiveness of food distribution firms to consumer preferences assuming a reasonably competitive environment.

Of particular significance is the potential of new and existing technology for reducing food distribution costs. Systems analyses in conjunction with computerization promise real breakthroughs in food distribution efficiency.

A. T. Kearney and Company estimated that more than $1 billion can be saved by the grocery industry annually through the application of cost analysis, industrial engineering and systems analyses and new technology to the distribution of products from source to retail shelf. This estimate was based upon Kearney and Company's experience in over 500 transportation and distribution studies and was reported at the 1966 annual convention of the National Association of Food Chains.

Another example is a study conducted by the USDA which indicated that processing retail cuts of fresh meat in central plants instead of in individual retail stores can result in substantial savings. The estimated savings represent approximately half of the operating costs, compared to those of a firm processing an equivalent volume of meat in conventional store backrooms.

And incidentally, it is not necessarily the large firms which are first to adopt new technology and reap the benefits at the expense of the smaller, less well endowed firms. In fact, I believe that it is usually the other way around. As an Extension Specialist in Food Distribution I am inclined to think that the public interest can often be best served by working with the largest firms.

And last but not least is the need to develop a more meaningful set of criteria for evaluating market performance and the conditions necessary for achieving desired performance. I believe that we must be careful not to impose arbitrary regulations or restrictions which may not accurately reflect consumer preferences or which may actually prevent the food industry from performing in the best interest of the public. Continued study is required and this is as it should be in order to foster the development of this vital industry so that it best serves our needs. To this end I trust that some of you will devote your talents.