Food Retailing Consolidation: Implications for Supply Chain Management Practices

Phil R. Kaufman

In recent years, the food retailing industry has undergone unprecedented reorganization through mergers and acquisitions among its largest firms. These actions have raised concerns about the degree of competition and the ability of large retailers to gain market power. Merging retailers often cite potential cost savings through consolidation of purchases from food and non-food suppliers. Because supply chain management practices encompass these objectives, it is likely that retailers will employ such methods to successfully achieve stated efficiency and cost reduction goals.

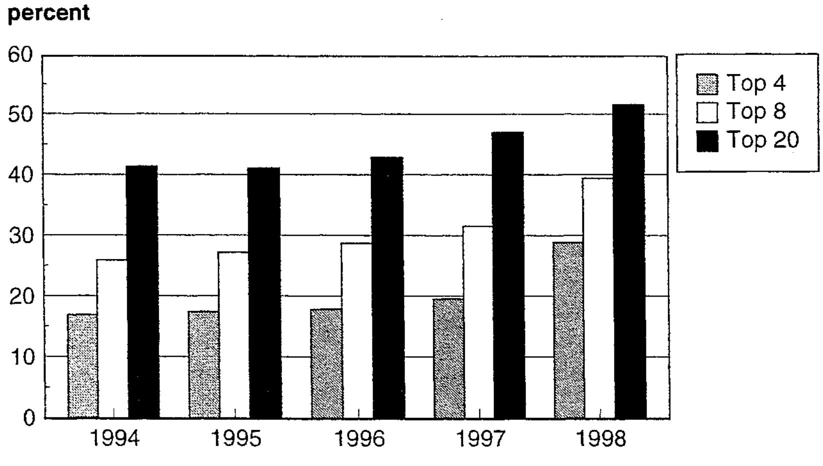
I first present three measures of consolidation, then discuss major mergers and acquisitions in recent years. I next identify the likely driving forces of retailer consolidation, after which follows specific supply chain management objectives and the practices that retailers are likely to adopt under each objective.

Aggregate Concentration

The impact of consolidation in recent years is evident when comparing changes in concentration from 1994 through 1998. The share of total U.S. grocery store sales by the top four, eight, and 20 largest food retailers is traced in Figure 1. Shares of the top four and eight retailers remained fairly stable through 1996. There was little change in the top four, eight, and 20 firms' share of sales, which averaged 17.4, 27.3, and 41.8 percent, respectively, over the three years. Between 1996 and 1997, the leading 20 retailers' share rose four percentage points, reaching 47 percent of grocery store sales while the top four and eight firm shares rose somewhat less. Aggregate concentration is estimated to reach new heights in 1998, with the top four shares jumping nine percentage points to 29 percent, and the top eight firms' share rising by eight percentage points to 39 percent. The top 20 firms' share increased less dramatically, reaching an estimated 51.5 percent (Figure 2).

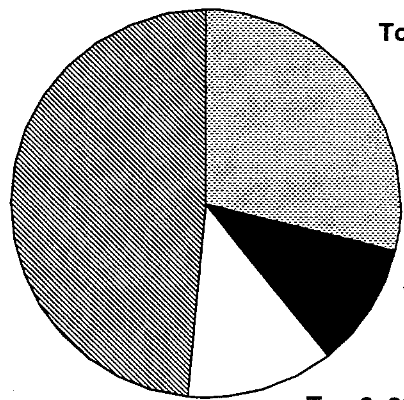
Aggregate concentration measures in food retailing are less comparable with other industries—such as food manufacturing, for example, whose largest firms typically serve national markets. Food retailers compete within specific geographic locations, such as cities or towns. With the possible exception of the resulting Albertson's/American Stores merger announced in 1998, no food retailers operate in all regions of the United States. Nevertheless, aggregate concentration provides an indicator of the net effect of internal growth, firm consolidation, and divestitures among the largest food retailers.

Figure 1. Top Four, Eight, and 20 Firms' Share of U.S. Grocery Store Sales.



Phil R. Kaufman, ERS/USDA, Washington, DC

Figure 2. Share of U.S. Grocery Store Sales, 1998 (Post-Merger Estimates).



Impact of Mergers and Acquisitions

Although the number of mergers and acquisitions involving food retailers also rose in 1997 compared with 1996 (totals for 1998 are not available), during the past decade, they have remained below the levels reached in 1988, 1989, and 1994. There were 44 food retailers acquired in 1997 compared with 37 acquired in 1996 and 42 in 1995 (Figure 3). Of the food retailers acquired in 1997, all but five involved other food retailers. Because individual acquisitions can vary in size from a few stores in a market area, to a division or entire company, the measure is less useful for gauging consolidation than for aggregate concentration. A better measure might include total assets acquired, total sales of assets acquired, or dollar value of acquisition purchases. However, these measures are not consistently reported.

More important to assessing consolidation than the number of acquisitions in a year is the relative size of firms acquired, as measured by the number of stores purchased, and their share of total stores acquired. In order to assess these differences, mergers and acquisitions during 1997 were assigned to one of six size ranges based on the number of stores acquired. Of the total number of firms acquired in 1997, the largest share of purchases—38.6 percent—involved 10 stores or fewer. These purchases represented only 2.1 percent of total stores acquired (see Figure 4). In contrast, only 29.5 percent of firm acquisitions involved more than 100 stores, yet they accounted for fully 86 percent of total stores acquired. We see in this breakdown that a small number of firms were responsible for the largest share of total stores acquired in 1997. The large share of stores acquired by these few firms has a greater impact on aggregate concentration than would be the case if acquired stores were more evenly distributed across all acquiring firms.

Recent Mergers and Acquisitions

Consolidation in food retailing has increased significantly since 1995. However, these mergers and acquisitions often have regional or multiregional geographic areas in common while minimizing overlap in specific local markets. Instances of overlapping markets would require review by federal antitrust agencies for their impact on competition. Following merger guidelines and other criteria, antitrust agencies may require divestiture of stores in overlapping markets that would otherwise have the effect of substantially lessening competition. Most recent mergers and acquisitions in food retailing have had minimal instances of overlapping markets, except where noted below. A summary of mergers and acquisitions, by region, is contained in Table 1.

Figure 3. Number of Mergers and Acquisitions, 1987–1997.

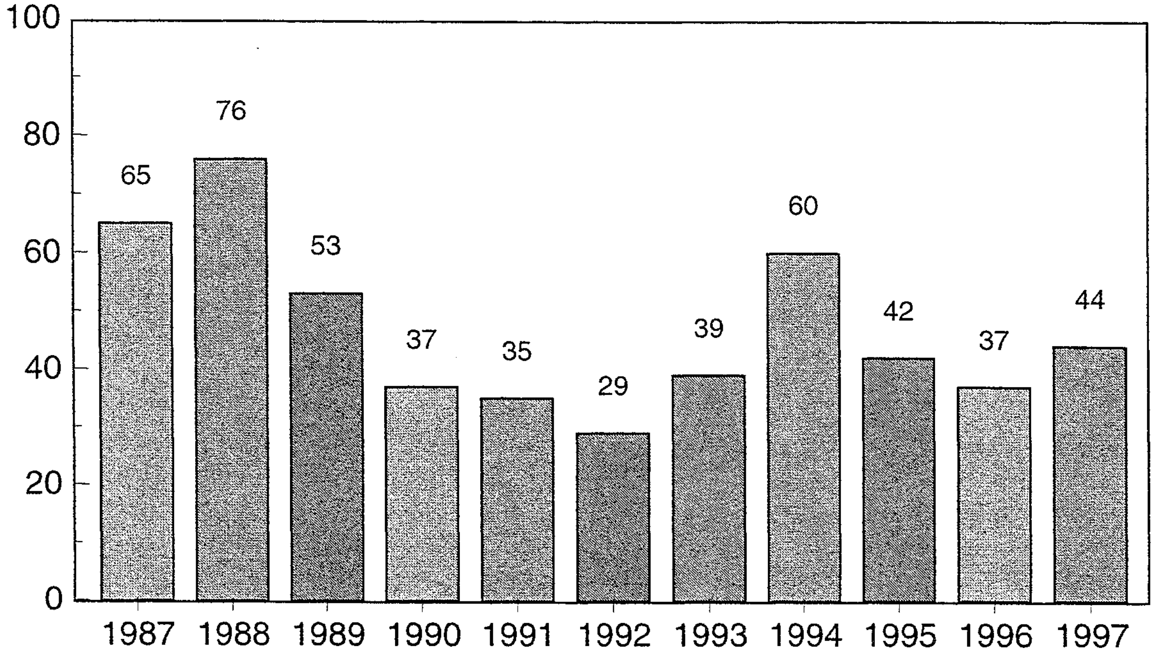


Figure 4. Share of Acquisitions and Stores, 1997.

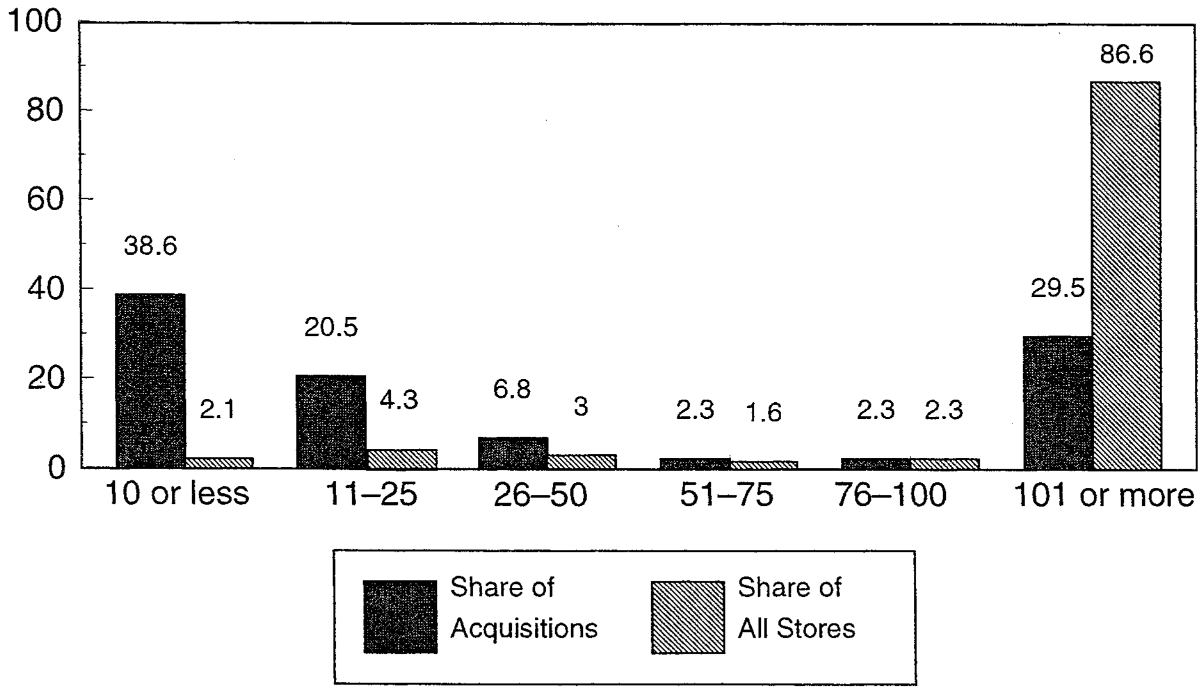


Table 1. Recent Mergers and Acquisitions in Grocery Retailing.

Pacific Region	
Safeway - Vons, 1997	
Yucaipa - Fred Meyer, 1997	
Quality Foods Centers - Hughes, 1997	
Yucaipa – Smith's Food & Drug, 1997	
Yucaipa - Quality Foods Centers, 1997	
Albertson's - Lucky (American Stores), 1998	
Midwestern Region	
Giant Eagle - Riser Foods, 1997	
Lund's – Byerly's, 1997	
Albertson's - Jewel/Osco (American Stores), 1998	
Northeastern Region	
Ahold - Stop & Shop, 1996	
Ahold - Giant Food, Inc., 1998	
Southeastern Region	
Food Lion – Kash 'N Karry (Florida), 1997	
Jitney Jungle - Delchamps, 1997	
Kohlberg & Co. - Schwegmann's (New Orleans, LA, 1997)	
Interregional	
Safeway – Dominick's (Midwestern), 1998	
Abertson's - Acme (American Stores), 1998	
Kroger - Yucaipa/Fred Meyer (Pacific), 1998	

Sources: Company annual reports; *Wall Street Journal* (various issues); *Supermarket News* (various issues); *Food Institute Weekly Digest* (various issues).

Pacific Region

In the Pacific region, Safeway, Inc. (Oakland, CA), acquired Vons supermarkets in southern California in 1997 (Arcadia, CA) through a stock purchase transaction valued at $1.65 billion. Safeway previously owned 35 percent of Von's equity in exchange for the sale of Safeway supermarkets located in southern California in 1988. Von's operated 325 supermarkets with sales of $5.0 billion in 1995. Safeway Stores is majority-owned by the investment firm Kohlberg, Kravis, and Roberts.

Also in the Pacific region, Quality Food Centers, Inc. (QFC)—headquartered in Bellevue, WA—acquired Hughes Family Markets (Irwindale, CA) for $358.8 million in March 1997. The acquisition would add 57 conventional and super-store-format supermarkets to QFC's 146 multiple-format supermarkets, resulting in combined sales of $1.2 billion. The retailer announced the acquisition as a first step toward becoming a multi-regional retailer of premium supermarkets.

Fred Myer, Inc. (Portland, OR)—operator of 101 hypermarket-format supermarkets—made several acquisitions in the Pacific region in 1996 and 1997 through its parent Yucaipa Companies, an investment firm. In 1997, it acquired Smith Food and Drug Centers, Inc. (Salt Lake City, UT) for $2.0 billion, including $1.3 billion in debt assumption. Smith Food and Drug had sales of $3.0 billion in 1996 through its large combination food and drug-format stores in Utah, Nevada, and Arizona. In 1997, Fred Myer also purchased QFI (Bellevue, WA) for $1.7 billion, which included the previously acquired Hughes Family Markets, Inc., in southern California, through its parent investment firm, Yucapia Companies. Another Yucapia Co. supermarket chain, Ralph's supermarkets (Compton, CA), also operating in southern California, was subsequently merged with Fred Myer. As a result, Yucapia, through its controlling equity ownership in Fred Myer, controlled 818 supermarkets with estimated sales of $14.9 billion in 13 contiguous western U.S. states.

In August 1998, fourth-ranked Albertson's (Boise, Idaho) announced plans to acquire second-ranked American Stores, operator of Acme Markets (Mid-Atlantic region), Jewel-Osco (Midwest region), and Lucky Stores (Pacific region) for $11.7 billion in stock and debt. Lucky Stores operates 448 supermarkets in California. Albertson's currently operates 971 food and drug-format supermarkets in 25 Western, Midwestern, and Southern states. American Stores (Salt Lake City, UT) currently operates approximately 1,560 stores in 26 Eastern, Midwestern, and Western states.

Midwestern Region

In the Midwestern United States, Riser Foods (Bedford Heights, OH) agreed to merge with Giant Eagle (Pittsburgh, PA). Both companies own supermarkets and food wholesaling operations. Together, the firms would operate 56 supermarkets and serve 586 independent retailers in Ohio, Pennsylvania, and West Virginia, with combined sales of $4.0 billion. The merger allows the two companies to serve new market areas and to gain volume efficiencies in grocery procurement.

As part of the Albertson's-American Stores merger, the Jewel/Osco Drug Division of American Stores was acquired. Jewel-Osco operates 184 supermarkets (all but 30 are food and drug-format) in the Chicago metro area.

In Minnesota, Lunds Food Stores—operator of eight upscale supermarkets—purchased Byerly's—which operates similar supermarkets mostly in the Minneapolis-St. Paul metro area. Combined company sales will amount to an estimated $387 million. The acquisition represents a high degree of overlapping markets.

Northeastern Region

Two large acquisitions took place in the eastern United States during 1996–97, continuing a regional consolidation wave. Ahold, USA (Atlanta, GA)—operator of several large supermarket chains on the East coast, including Giant Food Stores, Bi-Lo, Finast, and Tops Markets—acquired The Stop & Shop Cos. (Quincy, MA)—the largest New England grocery retailer with sales of $4.1 billion in 1996. Ahold purchased Stop & Shop—which was formerly majority-owned by Kohlberg, Kravis, and Roberts, an investment firm—for a total value of $2.9 billion. In May 1998, Ahold added to its supermarket portfolio with the acquisition of Giant Food, Inc. (Landover, MD), operator of 176 combination food and drug-format stores in the Washington, DC, metropolitan area. In recent years, Giant Food, Inc., had opened new stores in Delaware, Pennsylvania, and New Jersey under the "SuperValu" banner. Sales of Giant Food, Inc., reached $4.2 billion in 1997. Ahold, USA—a subsidiary of Royal Ahold, the Netherlands—generated U.S. grocery store sales of $14.3 billion in 1997.

Southeastern Region

In 1996, Food Lion, Inc. (Salisbury, NC)—operator of 1,100 conventional format supermarkets in the southeastern United States—more than doubled its presence in Florida with the purchase of 100 Kash 'N Karry (Tampa, FL) warehouse-format supermarkets with sales of $1.0 billion in 1996. Food Lion—a subsidiary of Delhaize Le Lion, Belgium—earned sales of $10.0 billion in 1996.

Jitney-Jungle Stores of America (Jackson, MS) acquired Delchamps, operator of 118 supermarkets in Louisiana, Mississippi, Alabama, and Florida for $260 million. Jitney Jungle operates a chain of 21 discount stores, 77 conventional stores, and seven combination stores for a total of 105 supermarkets located throughout Mississippi, Tennessee, Arkansas, Alabama, Louisiana, and Florida. The Federal Trade Commission (FTC) required the sale of 10 stores in order to preserve competition in overlapping markets.

In New Orleans, Louisiana, Schwegmann Giant Supermarkets was sold to Kohlberg & Co., an investment firm, for an undisclosed amount. The purchase in February 1997 included 26 of the 28 supermarkets operated by Schwegmann, with the remaining two stores sold as a requirement by the FTC.

Interregional

The largest interregional consolidation involved the acquisition of Yucaipa/Fred Meyer's western region stores by Kroger Company, in October 1998, for $12.8 billion. Yucaipa/Fred Meyer operated 1,181 retail outlets, including 800 supermarkets in 12 states, with sales in 1997 amounting to an estimated $15 billion. Kroger Company, the nation's largest supermarket retailer, owns 1,398 supermarkets in 24 Midwestern and Southern states, and 816 convenience stores. Kroger's 1998 sales were estimated to exceed $26.6 billion.

Safeway, Inc. (Oakland, CA) agreed to purchase Dominick's Finer Foods from Yucaipa/Fred Meyer. Supermarkets numbering 112 stores in the Chicago metro area were purchased for $1.2 billion. Dominick's sales reached $2.4 billion for the 12-month period ending in August 1998. The agreement was made just prior to the announcement of the Kroger-Yucaipa/Fred Meyer merger in October 1998.

As part of Albertson's acquisition of American Stores (see Pacific Region), the Acme Markets Division (Malvern, PA)—operator of 183 conventional and superstore format supermarkets in Delaware, New Jersey, Pennsylvania, and Maryland—was acquired. Acme Markets' sales in 1998 are estimated to exceed $2.0 billion.

What's Driving Retailer Consolidation?

While some would argue that the primary motivation for the spate of large mergers and acquisitions in recent years is to gain market power—

the ability to raise price above a competitive norm—a number of factors call this view into question. Especially in the product market, the market in which retailers sell to consumers, retail food firms compete within fairly small geographic areas, ranging in size from metropolitan areas, including the core central city and its surrounding suburbs, to smaller towns in rural settings.

As a motivating factor, the ability to gain market power over retail price would appear to have a minimal role in the recent mergers and acquisitions. Many of the mergers involved non-overlapping or minimally overlapping local markets. Where significant overlap occurred, the antitrust agencies (primarily the FTC) have often required store closings or the sale of stores to other food retailers in order to preserve competition. More antitrust concern has been focused on medium- and small-sized local markets, where the ability to dominate sales is possible by a single multi-store retailer. Larger metro areas with populations of 1 million or more have received less scrutiny because they are considered "contestable" in that they have low-entry barriers, and because of their size, a single firm would not be able to control a majority of sales resulting in market power. The pending Albertson's-American Stores merger may require antitrust review due to the number of potential overlapping local markets involved. As a result, the antitrust review process will likely limit market power gains resulting from food retailing mergers.

A number of additional factors also influence the ability of food retailers to raise prices. The economic climate of low inflation prohibits unilateral price increases by food retailers. During the five-year period, 1993–97, the ERS grocery store sales deflator—an index of food and nonfood price changes—averaged 2.3 percent.

Rising household incomes increase the propensity to consume more prepared foods and meals away-from-home. Of total spending for food, consumers spent almost 45 percent in the foodservice sector in 1997, compared with 43.9 percent in 1987 and 38.2 percent in 1977. In response, food retailers have increased offerings of prepared foods and meals for carryout. Such initiatives have likely slowed but not completely offset sales declines among their traditional food products.

Another important factor limiting market power has been the growth of nontraditional food retailers as an additional source of competition. A major contributor to the expansion of nontraditional retail food sales has been discount mass-merchandise and warehouse club outlets. These nontraditional retailers include large store-format retailers—such as Wal-Mart, K-mart, and Target—and warehouse club operators—such as Costco, Sam's (a division of Wal-Mart), and BJ's. Mass-merchandiser outlets have often included packaged foods and limited frozen foods along with general merchandise items. The introduction of the supercenter format by Wal-Mart in 1988—which includes a self-contained supermarket within a larger mass-merchandise outlet—has contributed greatly to retail food sales outside traditional food retailers. Food sales by nontraditional retailers amounted to $64.9 billion in 1997 compared with sales of $37.7 billion in 1992, a 72 percent increase. During the same period, food sales by traditional retailers increased 15 percent to $308.8 billion. As a result, the share of total retail food sales accounted for by traditional food stores declined from 87.7 percent to 82.6 percent from 1992 through 1997.

These consumer trends and new sources of competition have forced food retailers to seek performance gains through supply chain management practices.

Supply Chain Management Practices

Supply chain management practices are likely to play a significant role among consolidated food retailers as they strive for efficiency gains. Performance goals achieved through supply chain management practices include: (1) efforts to reduce operational and new plant and equipment costs; (2) efforts to reduce product and procurement costs; (3) efforts to reduce marketing costs; and (4) efforts to reduce distribution costs.

Reducing Operating Costs

Operating costs, including store overhead and related expenses, constitute about one-half of overall store gross margins. Given rising land and construction costs, coupled with the greater break-even sales requirements of the typical new store size, retailers are aiming to contain these costs through the acquisition of existing stores rather than building new stores.

Consolidating retailers also aim to reduce operating costs through economies of management and control. New information technologies, such as computer networks and store checkout scanner data, allow for the centralization of many management activities at company headquarters that were previously the responsibly of store-level managers. The availability of timely and detailed information at headquarters also allows for the effective control of operations over relatively large geographic areas.

Reducing Costs of Procurement

Through consolidation, retailers expect to achieve greater efficiencies in the procurement of retail products, including fresh fruits and vegetables. By offering larger purchasing volume to suppliers and distributors, retailers hope to lower the per-unit cost of goods by negotiating lower wholesale prices. In return, retailers can offer exclusive procurement agreements, such as partnering, long-term agreements, and other strategic alliances that have potential benefits to suppliers and distributors. Retailers also gain a more reliable source of supply and, over time, can work to develop a higher-quality and more uniform product, an important consideration in produce procurement.

Reducing Marketing Costs

Consolidating retailers have the potential to reduce costs associated with the marketing and selling functions of retail goods as a result of the strategic alliances described above. Cooperating suppliers and distributors can provide additional marketing services that formerly were the responsibility of retailers. These marketing services include the design and provision of in-store promotion and point-of-purchase materials, sales-event planning and advertising, and special packaging. Retailers may also make checkout scanner sales data available to suppliers and distributors in order to better evaluate promotions, seasonal differences, price responses, and other characteristics of consumer demand. By working closely with suppliers and distributors, retailers can reduce marketing costs while improving the effectiveness of store-level marketing activities.

Reducing Distribution Costs

Consolidating retailers can achieve potential cost savings through the streamlining of product distribution functions. Large retailers are typically self-distributing in that they 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, the use of cross-docking facilities, direct store delivery by suppliers, and selective use of specialty wholesalers—can obviate the need for large distribution centers and their associated costs. The number of distribution centers can be reduced while remaining warehouses can be used more intensively.

Although smaller retailers may be able to incorporate some of these practices, the large product volume resulting from consolidating retailers greatly facilitates their ability to initiate these new methods and to benefit from their potential cost savings.

Summary and Conclusions

Consolidation through mergers and acquisitions has contributed to rising shares of grocery store sales by the top four, eight, and 20 largest food retailers. Although aggregate concentration ratios have increased, mergers and acquisitions have generally involved non-overlapping markets, thereby limiting anti-competitive effects. Review by regulatory agencies ensures that, in instances of overlapping markets among merging retailers, steps are taken to preserve sufficient levels of competition.

A number of forces are pressuring food retailers to become larger, and those forces are likely to persist. Supply chain management practices enable consolidating firms to reap cost saving in store operations, procurement of retail goods, marketing activities, and product distribution. Suppliers and distributors to food retailers must be cognizant of these new developments and be willing to adapt to the new roles that they are being asked to assume in order to benefit from retailers offering greater purchasing volume and a long-term commitment to their clients.