



AgEcon SEARCH
RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search
<http://ageconsearch.umn.edu>
aesearch@umn.edu

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

WHAT SHOULD WHOLESALERS AND RETAILERS DO?

by

Gerald Peck

National Association of Wholesale Grocers of America

It's a privilege to be here this morning as part of this panel addressing the challenge of providing consumers with their "desired level of living." The question assigned me is "what should wholesalers and retailers do?"

As some of you know, I work with wholesalers, not retailers. Therefore, I will speak directly to the wholesaler responsibility. The retailer obligations are in many ways the same, but I can't speak to them except in general terms.

To respond to the question of what wholesalers should do for consumers, I first listed what I see as consumer wants. I included: information about the product and the terms of sale...the lowest possible price...control over the quality of the product...control over the safety of the product...nutrition built into the product...a choice of brands and sizes and types of preparation...convenience...and, finally, availability.

Obviously wholesalers have no influence in some of these areas unless the item is private label. Because private label is a minor part of the wholesaler's business, I will open the discussion with references to the typical wholesaling function. That means, for the moment, we will consider the nutrition built into the product and the convenience built into the product. Information about the product is the responsibility of the people who produce and process and package the product. That leaves wholesalers with

responsibility for distributing food products at the lowest possible cost and acceptable terms of sale, for providing maximum quality and safety control, optimum consumer choice and optimum availability of product. Wholesalers and retailers also share some responsibility for informing consumers about conditions in food marketing.

The answer to what wholesalers can do about food prices is summed up in the word productivity. Increased productivity is not only desirable from the standpoint of keeping prices in line for consumers, it is acknowledged today by wholesalers as necessary to their own survival. Productivity is the wholesaler's biggest competitive tool and biggest vulnerability.

Claims have been made that productivity in food distribution is decreasing. I disagree with that and I'll explain why in a moment. It's a minor point because while our productivity is increasing, our costs are increasing faster. The reasons we need productivity increases have been well documented in recent meetings of this group. It really boils down to the fact that costs are all going up, especially energy and labor..., that grocery distribution is labor intensive..., and that labor rates are increasing faster than productivity. A conventional grocery warehouse operation is over 80% labor intensive. Fully mechanized it can be reduced to perhaps 60% labor intensity. More important is the fact that the total wholesaling function, incorporating all expense factors

except investment in inventory, is over 60% labor intensive.

For twenty years I have believed in the inevitability of warehouse mechanization. However, it has developed very slowly and all we've learned so far is that successful installations are rare and the payout takes twice as long as anticipated. We still have a technology lag and we still have little hope for mechanizing anything but giant operations.

If the rate of increase in productivity equals the rate of cost increase we have a healthy standoff. Consumers win and labor wins and there is no contribution to inflation.

The fact is, that the rate of increase of productivity has lagged behind costs for the last decade. Wholesalers and retailers were able to absorb some of the difference but they had to find options outside of grocery distribution to cover the rest. For wholesalers, these other options amount to subsidizing food distribution.

Our data may not be typical for all wholesaling, but for a changing group of 40 wholesalers, total margin has increased over the past 10 years from 6½% to 8%. Net margin remains under one percent after tax. The increase in gross reflects changing mix in products sold much more than covering cost increases. The mix includes more perishables and more general merchandise.

Our concern is that wholesalers have not covered the cost of replacement of equipment and facilities with generated income. Nevertheless, they did absorb a major share of cost increases through more sophisticated systems and through maximizing economies of scale. This allowed most wholesalers to remain competitive. Some operators were just not equipped or were just too small.

Unfortunately, this accounts for some wholesalers who were viable 10 years ago and are out of business today. These same pressures encouraged mergers and amalgamations which allowed spreading increasing costs across greater number of units of merchandise shipped. These measures, to absorb cost increases, were not enough. So wholesalers turned to income derived from sources other than wholesaling. The most dramatic moves have been into grocery retailing and retailing of other commodities such as variety goods, clothing, or toys. There is some venturing into vertically integrated businesses such as grocery manufacturing and processing. A few got into totally unrelated types of business, such as church construction or trailer manufacturing. Among the more common income devices are use of the wholesaler's printing facilities for commercial printing purposes or selling computer services or adding general merchandise lines or expanding the types of customers serviced.

We have long identified the wholesaler's primary objective as lowest cost food distribution. Other distributors share the objective, but improved productivity in an individual operation is just one of our opportunities to impact food prices.

We need also to seek productivity improvement at points of interface between shippers and carriers, between carriers and receivers and between distributors and their customers. And finally, we must seek productivity improvements in the total food industry through functioning as a total integrated system.

Now, I'd like to comment on claims that productivity in food distribution has been decreasing in recent years. First of all, Dr. John Kendrick, chief economist of the Department of Commerce, reporting to NAWGA's productivity conference, identified that grocery

wholesaling sales per hour has averaged a 3% per year increase compared to 2½% for all merchant wholesaling. No one is happy with sales per hour as a productivity ratio, even when the dollars are meticulously adjusted, but it is a good indicator of the trend...and the trend is up.

The second fact I would point out is that NAWGA has measured productivity in tons and pieces per hour for 14 years. This has been for the warehouse only, not total wholesaling. In 1976 the average warehouse performance was exactly the same, 1.08 tons per man hour, that was recorded in 1962. In intervening years it has gone as high as 1.20 and as low as 0.94.

That's a pretty dismal record considering the advances in equipment and facilities during that time. But in 1962 we did not have specialists on the payroll for security, safety and sanitation, and we didn't need traffic managers and energy managers. During the same period of time, the nature of a ton or a piece of merchandise has changed. That's significant because to measure a productivity trend you must have a constant output value. It's easy enough to adjust the dollar value of a ton of merchandise but there are other characteristics that have changed to make that ton worth a good deal more to the retailer who buys it. For one thing, it is being received today on pallets or on carts which expedite the receiving function at the store and expedite the shelf stocking function in the store...for another thing, each case of merchandise is delivered now with a label affixed which provides information which helps in pricing the merchandise in the store and, in some instances, in providing unit pricing information...for another thing the number of pieces per ton have increased. This means that the shipping case quantity is related better to the needs of the retailer's shelf. It also

means that each ton requires a greater number of handlings before the retailer receives the merchandise. Finally, it is common today that a ton of merchandise, received by a retailer, contains a more complete mix of the products required in the store. This again reduces the retailer's receiving and handling and re-ordering costs.

If we could calculate the impact these things have on the value of a ton as the output in our productivity ratio I am confident that the tons per man hour figures we measure would trend upward and, because warehousing is nearly half of all wholesaling costs, the trend would suggest that productivity overall is improving. So much for productivity.

In conjunction with wholesaler's responsibility for lowest cost distribution, I mentioned a related responsibility for terms of sale. This refers to the whole area of merchandising cooperation between wholesaler and retailer. An advertised price, for example, is a term of sale and the consumer is entitled to that sale item at that advertised price. The wholesaler's problem is to anticipate the consumer response to ads in three or four hundred different stores in as many different neighborhoods. The product must be ordered long in advance of the sale and be physically in place in the stores at the time of the sale. That's all fairly straightforward, but not easy to do. There is another hidden responsibility, shared by retailer and wholesaler, not to buy too much safety stock to protect the position taken in the ad because what is left over represents additional cost in handling and storage and possibly an inventory loss. It's a difficult tight rope to walk. It's easy to understand why ad feature items are frequently those with a promotional allowance that compensates for the added inventory investment and handling.

Unit pricing might be considered a term of sale, and the retention of prices on individual packages might be considered a term of sale. These things the consumer encounters only in the retail store, but as we all know, the wholesaler has some working responsibility. The highly sophisticated backup computer work for unit pricing is impossible for individual stores. It's burden enough for a chain distribution center when all of its retail outlets are on the same merchandising program. When a wholesaler becomes involved in unit pricing for 100 or more individual independent customers the technical task is a big one. It's a penalty but it's being done.

Pricing individual packages may become a term of sale. If that's what consumers really want, the price may be the benefits of scanning. Wholesalers have a responsibility to help retail customers who are in a position to get into scanning. That means technical help in feasibility analysis, equipment selection, systems development and personnel training. It also means providing the backup computer capability and technicians to keep all equipment functioning.

Another area where wholesalers impact a consumer desire is protecting the safety of food products. This is achieved through maintaining a properly sanitary facility and providing the right temperature and humidity controls for product storage, and the right practices for product handling. Temperature, for example, is of prime importance in handling frozen food. Ten years ago it was a serious problem. Today there are few distributors who do not have adequate freezers and the proper vestibules for receiving and shipping operations which insure that product stays below zero degrees at all times.

We have also improved our capabilities in maintaining sanitary warehouses. The Food and Drug Administration has really captured our attention on this one. Some people maintain that FDA requirements are exaggerated for food products that are handled only in consumer packages packed inside shipping containers. Nevertheless, wholesalers and all other distributors continue efforts to achieve the perfection mandated by FDA regulations.

Wholesalers are also working on control of damage which affects both sanitation or food safety and productivity.

When consumers think of food safety they are not referring to, or even aware of, all of the handling practices of wholesalers. Consumers are only concerned with what goes into the retail package. They are alerted, on rare occasions, to a danger of contaminated or spoiled food. When this happens, wholesalers are involved in the process of product recall. NAWGA has established a working arrangement with FDA and the computers at Western Union which permit us to provide instant information directly to all our members any time of any day. It's an expensive device and we're delighted that we get very little use out of it.

Another consumer service due from wholesalers is protection of quality of food products. This really overlaps the function of protecting the safety of products. Nevertheless, the wholesaler does assume specific quality responsibility when providing perishable items for retail customers. Whether the commodity be fresh meat or produce or dairy, bakery, or delicatessen products, the selection and purchasing, handling and storage functions of the wholesaler must be timely and correct and effective. This is another area that could provide the total agenda for a meeting like this.

It's worth noting that today more wholesalers are building perishables handling facilities. These same wholesalers were content to let local jobbers have the business, especially produce, until recently. Historically, wholesalers have gone into the produce business only when necessary to keep their retail customers competitive and insure a continuing quality source of supply.

There's another aspect of quality which bothers a great many consumers. I have a friend whose respect for me is strained because I'm part of an industry which practices the monstrous crime of selling snacks and cereals with sugar coating. He sincerely believes the practice should be outlawed. He's also a heavy smoker and he wants to make his own choice to smoke or not. There is an inconsistency somewhere even if the dangers are not exactly comparable.

There are a few people willing to make arbitrary decisions for all 200 million of us on what we can buy or whether we should have nutritional additives in some foods or whether to exclude additives of any kind from all foods. These are pretty heavy decisions raising serious questions of individual freedom. I'm excluding of course, those decisions that must be reserved for the Food and Drug Administration on food safety. I believe that choice is a privilege that should be preserved for consumers whenever possible.

Wholesalers are required to make choices that affect the consumer. These are the choices of what specific items will be handled. There is an economic limit on the number of items that can physically be handled and stored and protected. The wholesaler therefore, selects the items wanted by retail customers. In many cases committees of retailers make the choice. And what the

retailer wants is what the consumers want in each individual neighborhood.

I don't believe there has ever been a problem, because wholesalers or retailers make choices of what items to handle. If any want is missing, consumers simply turn to the competition. The industry may actually be guilty of trying too hard. For 25 years, I have heard distributors say "It's time to eliminate the slow movers that cost more to handle than they produce in gross margin." But they have not been effective in weeding out slow movers because they are unwilling to discontinue an item that even one customer wants.

The other side of the coin from consumer choice is the problem of proliferation of items. New item introduction has been slowed down, first by the wage/price controls, then by recession and the cost of capital. New items add to proliferation only when they are successful and some other item is not dropped to make room. This illustrates another tight rope the wholesaler must walk. When the consumer looks for green beans, there should be a choice of canned or fresh or frozen and a choice of sizes in each. There should be choice in the way the beans are prepared for use. There should be a choice in brands which means a quality and price distinction. The wholesaler must find the middle ground between choice for consumers and un-economic proliferation.

As the industry moves toward regional distribution centers serving all types of retail outlets, the job of providing choice will get tougher. There will be fewer distribution centers and they will each have to provide the full range of item choice.

This leads us to another wholesaler responsibility, making products available. We're all happy that fresh fruits and

vegetables are available year round rather than just during local growing seasons. But "availability" is a great deal more complex than shipping produce from one country to another. It means having the product in the store the consumer wants to patronize on the day and at the hour that the consumer wants to visit that store.

One aspect of this logistical responsibility has been measured by what the industry calls service level. 100% service is delivering every case wanted by retailers on the day they want them. Ten years ago, many wholesalers were able to deliver whatever the retailer ordered 97% as ordered and on time. Some called it a 97% service level and others just called it 3% outs. An investment in safety stock was required to maintain that service level.

Since that time, we have had a succession of shortages of many products and periods of rapid price increases. Replacement costs became a serious burden. Protection stock could not be maintained with available cash flow. As a consequence, service levels dropped from 97% to as low as 85%. With stabilization during the last two years we have a return to service levels that insure product availability to consumers.

The last and newest wholesaler responsibility is information for consumers. I submit that most wholesalers and retailers are doing a good job in the other areas I mentioned. But accepting responsibility for informing consumers is a new concept. Some wholesalers, but too few, have consumer panels or staff positions representing consumers. All such effort is made in the name of retail customers because consumer contact is limited to retailers and consumer awareness is directed primarily to grocery retailers.

Dialogue with consumers and providing information to consumers is a great opportunity and it must be expanded.

I have tried to respond to the question directed to me. It has meant covering a lot of old ground with just a reference or two to some new areas.