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Economics of the Frozen Food Distribution System

by

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It's a pleasure to talk to you this morning about frozen food distribution. The National Frozen Food Association was founded just 40 years ago as a frozen food distributors organization. Although we have grown to include every segment of the frozen food industry, I have long had an interest--and an admiration--for the frozen food distribution side of our industry.

We've come a long way since 1945. Some of you may remember the way things were then. There weren't many food distributors who had freezer space. That was because few retailers and even fewer consumers had freezers.

The foodservice side was somewhat better. Some restaurant operators owned small freezers. In fact, most frozen food products were oriented toward foodservice. Restaurants found their customers liked to eat strawberries in January.

It was not until the 1950s that frozen food distribution began to change. Post-World War II affluence enabled homeowners to buy refrigerators with freezing compartments. This opened the door for frozen foods.

Progress continued to be slow, however, as the industry's ability to manufacture frozen foods clearly outpaced the food distribution system's ability to store it. It was not until the late 1960s that distribution began catching up with the market.

And it wasn't until the 1970s that frozen foods started to take their rightful place in food retailing.

Homemakers learned to freeze foods on their own with their home freezer units. Home canning to preserve food became less important. By doing it themselves, consumers learned the advantages of freezing . . . and they liked it.

The American population has also been changing. There are more single-adult and two-adult family units. Continued affluence has enabled these families to do things their parents could never afford to do. They've taken greater interest in new experiences, travel, good food, and making the most of every waking moment.

Frozen food packers recognized this trend in the late 1970s and began introducing up-scale frozen products that have truly revolutionized America's eating habits.

- Frozen dinner and entree sales have nearly doubled since 1980.
- Frozen ethnic and regional foods--like Mexican, Oriental, and country foods--have shown substantial growth.
- And frozen pizza sales have quadrupled in ten years.

I was talking to one convenience store chain CEO a few weeks ago, and he said his

stores had recently gone from four-door freezers to six doors . . . and were looking toward eight doors in the near future. That's double the freezer space for that chain in about three years!

It's a growing industry. In 1984 frozen food dollar volume grew 10.2 percent over the previous year. That's double the growth of any other food category. While frozen food tonnage increased 1.5 percent, dry tonnage actually dropped 1.5 percent for the same period.

At the same time, the general U.S. population increased only 0.9 percent. This is significant in that it indicates growth in per capita consumption of frozen food and reaffirms that the consumer increasingly perceives frozen foods as a quality and convenience value.

Frozen food warehousing is keeping pace. According to the U.S. Department of Agriculture, total warehouse freezer capacity in 1973 was 889 million cubic feet. In 1983 it was nearly 1.2 billion cubic feet.

Technically, we're seeing the benefits of cheaper computer processing with thousands of times more capacity that enables the industry to collect, manipulate, and evaluate information that was only dreamed of a few short years ago.

This same development has made sophisticated automatic storage and retrieval systems and individual case selection systems a reality. Computer-to-computer communications between customers, brokers, manufacturers, and warehouses is also here. So is practical operations analyses of difficult-to-manage warehouse layouts and operations.

Legislatively, we now enjoy an environment that is driven by the marketplace and not by antiquated regulations. The railroads are now truly interested in the food business, and in particular the frozen segment. The trucking industry isn't truly deregulated but rather re-regulated in the correct way.

It's easier and better now. There is more carrier competition . . . and the result

is better service at equitable pricing. Trucking companies, as well as private carriers, now have the opportunity to run efficient operations through expanded operating authorities and routes.

Our association recently updated a supermarket profitability study that shows frozen foods to be most profitable. Here are a few things we learned:

- Frozen food profits contributed from 5.9 percent to 14.2 percent of all store profits.
- Average net profitability as a percent of sales was 10.9 percent.
- The average gross profit margin was 29.9 percent.
- The weekly gross return on investment averaged 24.1 percent.
- The average frozen food department product turnover rate was 29.6 times per year.
- A sales increase of 10 percent represents a 21.1 percent net profit increase.
- A sales increase of 25 percent results in a 54.5 percent net profit increase.

These conclusions are generally supported by reports from retailers across the country. But we are now looking at the new way of studying retail profitability--Direct Product Profitability, or D.P.P.

Our study dealt mainly with gross margins to determine profitability. D.P.P. will give us a way of determining the total cost of handling a particular product through the entire system.

Research like this can be particularly valuable to everyone because it tells us all where to place our emphasis and attention.

The National Frozen Food Association also sponsors two other continuing projects.

The first project is our annual National Frozen Food Month promotion. It's unlike

any other promotional campaign in the food industry. Instead of collecting a big war chest and developing a massive advertising campaign to sell more frozen foods, our promotion uses people.

Nationally we have some 35 leaders from every segment of the industry to give us their best thinking on how we can promote frozen foods better. We've divided up the country into six regions--each region has one or two regional coordinators who're principal frozen food sales executives for major manufacturers. These coordinators work directly with more than 50 local frozen food committees and associations in most of the major retail markets.

All these people work as volunteers to encourage every segment of the frozen food industry to give a little extra promotional push to frozen food products for March. We can't ask anyone to do any more than they can afford . . . and we don't tell them what to do or how to do it. But we do stand by to give them all the help a trade association is able to provide.

In 1984--the first year we ran the promotion--industry sales increased 6.7 percent. That was the highest monthly increase SAMI ever recorded for any food category!

In March 1985, our tonnage sales remained at about the same record level of the previous year . . . but dollar sales jumped another 6 percent over 1984. This reflects the consumer's growing interest in up-scale products.

We're already at work for 1986, and expect our Third Annual National Frozen Food Month observance to be bigger and better than ever.

The second project I'd like to tell you about is our Certificate of Excellence program for frozen food warehousemen and distributors. The program is operated in conjunction with the American Sanitation Institute.

Under the program, a distributor or warehouse firm may voluntarily request an inspection of its facilities. The American

Sanitation Institute does the actual inspection. When we receive a favorable report from A.S.I., we issue a Certificate of Excellence to the company's facility . . . and provide them with truck decals and logos they can use in their advertising.

We also publicize certificate holders in our association publications . . . and in news releases to the trade press and to the local news media.

Now let's talk a little about the future.

The total frozen food distribution chain is becoming more efficient. With a growing market that has limited facilities--for now at least--the industry must develop and foster the sophistication of which it's capable.

There are three main areas I'd like to briefly review--Electronic Data Interchange . . . Direct Product Profitability . . . and modularization.

EDI communications in general should allow for better buying and service decisions. Wasteful and error-prone phone and Telex/WTX orders are a burden on everyone's part. Whether the actual lead times can be shortened or not remains to be seen. Either way, better decisions are possible.

As you heard earlier, the concept of Direct Product Profitability is not only a natural process or progression, it's essential for the retailer to maximize his profitability and--at the same time--meet consumer desires at the lowest shelf price possible.

Gross margins alone are just not the most effective way to evaluate the profitability of a product, especially in frozen foods. The total cost of handling a particular product through the entire system must be evaluated. I think the progress in D.P.P. in the next few years will be very interesting.

D.P.P. and the dynamics now taking place in the transportation and warehousing of frozen foods leads us straight into probably the most significant opportunity area in frozen food from a distribution standpoint--

modularization.

Modularization has been receiving a great deal of attention in recent months and will get even more over the next few years. Granted, everyone doesn't sing its praises.

Modularization geometrically relates shipping case sizes to one another and to a common unit size. Or, to put it another way, it allows the industry to handle cases of product in unit load quantities where the unit load "module" is standardized, and achieves the maximum utilization of the space required to accommodate it. This means getting the best surface utilization of the storage/transport medium used whether it be a pallet, slave board, or slip sheet. This "module" should also achieve the maximum utilization of the rack space used to store it, and the same for the transportation vehicle used to transport it.

The key element in this whole thing is establishing the "standard" module. Virtually every warehouse layout and rack configuration is different. Even manufacturers have difficulty standardizing case sizes and pallet patterns for a single product produced at several locations.

In summary, we think frozen foods are coming of age. We're finding growing consumer acceptance . . . that's changing to positive interest . . . that's trending toward outright demand.

At the retail level, this translates into increasing shelf space, more and better products, faster turnover, and greater profits.

On the foodservice side, it means cutting kitchen preparation and personnel costs while providing a varied menu of consistent quality.

For distributors, the growing interest in frozen foods requires investment in either more efficient handling of existing freezer space . . . or construction of new frozen storage facilities. In some cases, it means both.

Again, thank you for the opportunity of being with you today.