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# Keynote Address

by

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First of all, I have to ask for your patience and your forbearance. As you see, I seem to have a problem with the language. I didn't know I really had a problem until last year: I was invited to give a talk at the Agriculture Canada Outlook Conference. As you probably know, in Canada there are two official languages--French and English. If someone's speaking French, there's instantaneous translation into English, and vice versa. So, if there's an Englishman giving an address, the French speakers pick up their earphones. I noticed when I got up to speak--I said about three words--both the French speakers and the English speakers picked up their earphones.

I want to talk this morning about what I see as the changing face of food distribution, and I'll talk about this in an industry sense rather than specifically related to Safeway.

Food distribution is changing, and it's changing especially in retail--or that's where I see it changing most. The changes represent real opportunities, and yet, ironically, the information explosion in the food distribution business sometimes makes it difficult to take full advantage of the opportunities. Of course, we need all the information we can get--we need more and more details and more complex information in order to run our business.

Now how is the food distribution industry changing? First, our markets are changing. Second, our customers are changing, and third, competition is changing.

**Changes in the Market**

Perhaps the greatest change is in the area of sales expectation. The retail food business went through a long period where we took sales increases of 10 to 15 percent a year for granted. This year, the industry as a whole will be lucky to have reached 3 to 4 percent. Some areas may even show a negative increase.

Why the dramatic drop? First, there's been a change in the rate of population growth. Our population grew by about only 2 percent in the 1950s, 1.5 percent in the 1960s, 1.1 in the 1970s. Our expectation from now through the end of the century is 0.8 percent per year. We're going to get fewer sales per population group.

Second, inflation, as you all know, has dropped dramatically. Inflation was 10+ percent in 1981; yesterday, in 1985, 1.6 percent. And there's one thing inflation does--it always makes your sales look that much better than they were last year. So we need a very dramatic change in our thinking about the coefficients used to measure our business.

People's incomes are not rising as rapidly as they were. As you're well aware, in many industries, there have recently been rollbacks in wages--resulting in a much slower rate of income growth.

The things which provide the power for our industry are not likely to increase rapidly in the near future. Indeed economic prospects for 1986 are relatively bleak. We'll continue the low salary adjustments. One reason for this is that the profit level for most corporations are not expected to be as high as they were this year. In the case of the wage agreements that had COLA clauses--the COLA clause probably will not take effect in 1986. Interest rates are down and therefore one of the great sources of increased incomes for shoppers--interest income--will be less in 1986. Consumer debt and installment debt are at record levels and increasing proportions of people's incomes will be taken by debt services.

I have a shock absorber theory about food retailing. People take out their fixed expenses--their house mortgage, their car payments, necessary payments on their credit cards, etc. What's left is what they take to the supermarket. And we become the shock absorber. If you don't believe me, look at what happens to retail sales in the first two months after Christmas as people pay their Christmas bills.

And all this means that if I want to increase my business, I've got to take it from somebody else. In the fifties and sixties, the whole was growing. We could all expand, but now it's becoming much more competitive. If I'm going to grow, I'm going to take it from somebody else, and they're going to shrink. I've got to take from someone who's not willing to give it up. This means we need more fine tuning in the marketplace, and we need more information for this. We need to be more professional and more efficient in our operations and in our management. When we had rapid inflation and rapid market growth, we didn't need to fine tune anything. Now we certainly do.

**Changes in Our Customers**

Second, our customers are changing. I don't mean, of course, that when you look at the customers waiting at the checkstand you see a group of "ET"s. Some of the changes are very subtle.

First, households are becoming smaller. Since 1970, the average size of a household in the United States has gone from 3.1 people to 2.7; and it's 2.5 in California. There's an increase in the number of single persons and in the number of single heads-of-household. A high proportion of these are women with children. In fact, it's estimated that, within the next decade, 45 percent of the households could be of this type.

You've heard many times about the increase in the number of working women. Women are now 41 percent of the work force; they'll be 43 percent by the end of the decade. At the same time, there's an increase in two-income households. It's estimated that there are 26 million two-income households at present. This will increase to 33 billion by 1990, and the average income of the two-income household is 40 percent higher--at $30.1 thousand as compared to $21,700 for the average household. What's also important, though, is that, in about a third of the two-income households, husbands prepare at least one meal a week. This is changing the pattern of shopping, which I'll talk about more later on.

There's also an increase in so-called affluent households. It's estimated at present that 11 percent of the households in the United States have incomes greater than $50 thousand. But in ten years, this will double in real terms. This is a group that's very attractive to retailers--a group with higher discretionary income.

The number of people 65 and older is increasing. It's estimated that the number of people 65 and older will increase by 33 percent in this decade.

The number of people under 18 is decreasing rapidly. It's been estimated that within the next decade this number will go

down by 18 percent. Think about the implications of that for the fast food industry, much of which now bases its whole marketing strategy on youth. You notice what's happening in that industry: they're expanding their menu, offering more sit down facilities, salad bars, and so on, trying to cater to a broader market, and expanding into the market. In fact, by 1990, the number of people 65 and older will be greater than the number of teenagers. That's never before happened in the history of this country. We need this information and need it constantly updated to run our business.

There's another subtle change. This involves ethnic shifts. At present, 9 percent of the U.S. population is Hispanic, 12 percent is black, 6 percent is Asian. But these are the most rapidly growing segments of our market and for many of us these are neglected markets. What's even more important, there are many markets in which we operate where these are a majority of our customers: east Los Angeles, Houston, El Paso, San Jose, to name but a few.

With these demographic changes, we're also getting changes in shopping habits. We're getting more men shopping. In some of our markets, 40 percent of our customers are men. We're getting more teenagers shopping. No doubt most of you have the FMI survey that said that 64 percent of teenagers are involved in some way in consumer and family food shopping. There are two things that happen with men and teenagers: they make less use of shopping lists, less use of coupons. What we need to appeal to this segment of the market is different. We also have noticed that men purchase fewer health and beauty aids and general merchandise in grocery stores.

People are spending less time in the store, and one of our major problems is the question of dullness. People talk about "going to the supermarket." They go and "shop" for clothes and other things that they find more interesting.

There's increasing demand for small portions. On one hand, we, in order to reduce our labor costs, want to put our meat out on larger trays; but our customers are looking for smaller portions.

Demand is increasing in some markets for service--service in the product, service in the store.

We all know about the dramatic drop there's been in beef consumption. I don't see this stopping.

There's increasing demand for food considered of high nutritional value. People are more diet and health conscious, and I don't believe this is just a fad. I believe this is the direction we're moving in. The words "light," "lean," and "natural" are words very much in vogue. Think about the growth areas in our stores: greens; lean meat, poultry; seafood; fresh, whole grain breads; low fat milk; and especially, produce. Ten years ago, when you asked people why they shopped at a particular supermarket, the answer was meat. Now, two out of four people say produce--quality and selection. Many supermarkets like us have increased the number of items in the produce department from about 65 items to about 220, trying to meet this demand.

People are concerned about fiber. They are concerned about salt. They are concerned about cholesterol. They are concerned about sugar--particularly the older people, who, as I said, are making up a growing segment of the market.

Of course, we see contradictions. We have a shopper who'll go down one aisle and buy caviar, down another and buy wheat; at the meat counter he'll buy filet mignon then go down another aisle and buy generic toilet paper. At a time when people are concerned about health and nutrition, candy sales keep growing. Sales of salty snacks keep growing, and if you look at the statistics from USDA, consumption of fats and oils continues to increase.

Our market is becoming more fragmented, and that makes it much more frustrating to a retailer. It was much easier in the days when we talked about that homogeneous customer, Mrs. Consumer. Today, apart from

being a very demeaning term, it is also totally inappropriate for the market we face. But many of these changes I've talked about appear at the margin. It's not as if the whole population is moving. There's still a whole lot of Middle America out there, but growth is occurring in these areas, and in these changing tastes I'm talking about. They vary from area to area, and we need to be very wary of generalizations and industry cliches.

**Changes in Our Competition**

We're also facing much more competition. We're facing more conventional competition with new stores, with increasing numbers of departments in stores. One of the major ways that retailers compete is with facilities. But in addition to this, we're facing a lot of non-conventional growth and competition. Food sales through drug stores--I challenge any of you to look at the flyer from a drug store and look at the items on the front page. Ninety-nine percent of them, if not 100 percent, are traditional grocery store items. This is happening at the same time that we're putting in more health and beauty aids and adding pharmacies to our stores. We're competing more with drug stores, department stores selling food, variety stores, gas stations, food plants, freezer outlets. There are more than twelve different types of outlets that are growing more rapidly than the conventional supermarket. Think about the specialty stores. If I had said here ten years ago that someone could take a single item like a chocolate chip cookie and turn it into a very successful chain of stores, you would have laughed at me. But just that has happened in California.

We as a company, like most other retailers, have reacted to these changes in the marketplace by offering different formats. We have more than thirteen store formats at the moment. Ten years ago, a Safeway store was either 15,000 square feet, 25,000 square feet or maybe 28,000 square feet--a rectangular box. Now each of the thirteen formats is unique--each offers a different merchandising approach, different services and a different type of store operation. This reflects the structural change that's going on in the industry.

Recently in the Wall Street Journal there was an article about drug stores which quoted Willard Bishop. Let me relate the figures to you: Conventional stores have gone from 30,250 in 1908 down to 19,500 in 1984. From 30,250 in 1980 down to 19,500 in 1984--that is a very dramatic decrease. That change is continuing. The number of superstores (same as the supermarket with at least 30,000 square feet) has gone from 3,250 up to 4,600. The number of small stores has gone from 96,000 down to 84,000. The number of warehouse stores has gone from 920 up to 3,250. The number of convenience stores too has grown from 35,800 to 43,000. The number of food-drug combination stores has gone from 475 to 950. The number of super-warehouse stores has gone from zero up to 95. The limited assortment store has virtually disappeared. In all these developments, the retailer is trying to provide what a particular market wants: different product emphasis--emphasis on produce, on meat, on service. The concept of one store, one size fits all has gone, and gone forever.

Retailers are also putting more specialty departments in their stores. Think about how many stores you see now that have a cheese shop and deli, a garden shop, sit-down foods, an in-store bakery, a soup and salad bar, a lobster tank, a pharmacy, a gift center, dry cleaning, check cashing, ATMs; they sell insurance, liquor, seafood, to name but a few. We are trying to cater to the wants of the consumer by increasing the number of specialty departments, particularly in our larger stores. Many of these departments, however, have a relatively short life-cycle (look what happened to video games, for example).

**Concluding Remarks**

We're finding that no two stores have the same customer mix and the same product demand pattern. Therefore, we need more market research and more information. Increasingly, the focus needs to be on a particular store. Although difficult to use, scanner data has fortunately come along to help and many retailers are now using scanning

data not only for product movement inventory and reordering but are also looking at it to analyze stocking patterns, shop allocation, price elasticity and price-volume relationships.

We also need to examine the promotion sensitivity of products. Which items are sensitive to promotion; which ones actually bring in additional business and which ones just cannibalize future sales? Another research area involves trial and repeat of new products--the use of scanner diary panels.

There's an increasing interest at retail in the question of image and tracking a store and a company's image over time. What we need to look at is the blend of quality, service, price, facilities and perishables. How do our strengths and weaknesses compare with our competition's? How are these things changing over time?

There's an increased interest in positioning. We know now that we can't be all things to all people. Which is the appropriate position for us in the market? What position has been assumed by our competitors? Where are they vulnerable? Where are the opportunities for us?

There's an increased interest in marketing. In retailing what we used to call "marketing" was in fact "in-store merchandising," but now we're recognizing that we do need to think about marketing, to think about the four "Ps" and all those things. We do need to inform, not just through our in-store merchandising but through our advertising, our facilities and our service.

And we need to be concerned about consistency--consistency between what we promise in our advertising and what we deliver in the store. We need consistency among our advertising, in-store performance, price, facilities, product mix, selection and service. And these need to be consistent with the particular type of store we're operating--are we operating a warehouse store, a convenience store, a super store, a super warehouse store, or a blend of some of these? The worst thing we can do is to promise something in our advertising and not deliver it when the customer walks into the store.

In retailing, as in most industries, there's increasing concern with the return on assets. We are becoming less tolerant of poor performance, poorly performing assets, poorly performing people, and, for those of you in the manufacturing industry, poorly performing products. One thing that is happening with scanning is that new products are getting less time to prove themselves.

There is concern at retail with the question of buying versus making. Do we need to make the product ourselves? Do we need to provide every service ourselves or can we buy it cheaper?

There's also a concern with competence. By that I mean, as was expressed in Search for Excellence, sticking to your knitting. Competence is doing those things for which you have some skill and experience. We've seen so many times in retail where people have branched out into new fields and have not had the management or technical skills to handle that particular operation or those products. Inevitably the new venture fails.

We're also concerned with efficiency--our efficiency in the store as well as the efficiency of the whole system. Some companies like Proctor and Gamble have now become much more concerned about the efficiency of the whole system, and they have now redesigned the Crisco bottle to use shelf space more efficiently. A recent article in Fortune cited Tony O'Reilly, the CEO of Heinz, who said, "We have to be the lowest cost operator in the business to survive." And Heinz put a tremendous effort into increasing the yield and reducing the cost of their French fries, for example. This is happening in many industries--in manufacturing, in distribution, in retail.

There's increasing concern for getting adequate return on the advertising dollar. There's much more advertising research going on. Manufacturers and retailers are concerned not only about recall but also about attitudes toward products. Researchers are looking at attitudes towards TV

commercials, at tailoring programs to the particular product being advertised.

We have an added problem of shorter life cycles. It was always estimated that the life cycle of a grocery store was about ten years. It seems to me now that the life cycle is shortening down to possibly eight years. This means that after eight years, we need either to replace the store at a cost of maybe four to five million dollars or remodel it at the cost of maybe a million dollars. We're getting shorter life cycles both in products and in concepts. Think about the concept of the warehouse store. Its life cycle was about two years. And it was superseded by the super warehouse store.

We in the retail business are going to be testing new concepts, new facilities in an effort to get a competitive edge. But we're also thinking much more in terms of future flexibility than in terms of establishing the best program ever invented and sticking with it. We must be much more flexible in our thinking because the times are changing, the markets are changing, the customers are changing, the competition's changing.

Clearly, in this rapidly changing environment and in the increasingly competitive marketplace, we're faced with increasingly fragmented and hard-to-manage businesses. We need much good information, accompanied by high quality, practical analysis. Organizations such as the Food Distribution Research Society can play a very useful role in this regard.