BANQUET SPEAKER

Comparative Food Distribution Industries

Canada, Europe and the United States

by

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It is a great honor for me to be able to share with you tonight some of the observations I have been able to make in North America and in Europe over the last fifteen years. The food distribution business has evolved so quickly on both continents that keeping abreast of developments is almost a full-time job. I have been fortunate enough, through my background, to be in a position to know the two continents quite well from the start. This has helped me to understand better the forces at work, to integrate and interpret information faster so as to draw the necessary conclusions. I have also been fortunate to graduate from one of the best universities in the wonderful land of the United States of America. This experience not only helped me understand better the competitive dynamics in the U.S. marketplace but also brought me to choose the food industry as a career. I have never regretted it since. It is without any doubt, one of the best businesses to be in and one of the most exciting industries to follow.

Today my job brings me to work with many of the key players in the marketplace on the two continents. My employees and I spend a considerable amount of time researching the market and building marketing strategies for companies headquartered in Canada, the United States and Europe. It has advantages and disadvantages. The disadvantage of being in this business is that you have to spend your life in planes and in airports, which is fun when you do it once or twice a year, but is no fun when, as I do, you are stuck having to go to Europe once every three or four weeks. In between European trips, I have the pleasure of rediscovering on a regular basis the niceties of O'Hare, La Guardia or other friendly places to be in at six in the evening. However, apart from that, this career has a lot of advantages. The main one is that you do not have to wait for Progressive Grocer or Supermarket News to know what is happening in the marketplace.

I will try tonight to give you a good idea of what is happening in the food distribution business in Canada and Europe and I will draw a parallel with what is happening in the United States. I am sure that all of you do not need to be reminded of what is happening here and many among you have been to some

European countries recently. However, since evolution never happens in a vacuum I will try to compare the U.S. evolution with Canadian and European experiences so that some indication as to future trends can be shown.

As a start, let me define what the context is. Twenty years ago the European and North American continents were a world apart in terms of distribution, marketing, consumers etc. North America was leading the world; Europe was not in the race. Today we are still leading the world, but barely, and you all know that many innovations have come from outside North America. The growth of Europe has been particularly dramatic. It is due to a tremendous increase in productivity and a constant search for new ideas. In North America one has to recognize that often enough business has been complacent about the innovation process and the search for a better productivity. Luckily there was a big recession recently that I am sure you heard about. This recession forced business to start thinking again. The resulting impact was positive and new ideas are now being adopted at a much faster rate, including in the distribution trade.

Today, in 1984, the socio-economic context is more and more the same in North America and in Europe. Productivity in North America is increasing again at a very good rate while in Europe the rate of productivity growth is decreasing, thus giving North America the chance to be competitive again. Consumers are changing on both continents, and moving in the same general direction, either in terms of socio-demographics or life-styles. There are now many common characteristics and many common concerns between North American and European consumers. For the distribution business it can only mean that more and more stores and distribution channels will look alike between the two continents in years to come.

I am, however, speaking for the long term. Short-term-wise there are still major differences that are worth noting.

The first one comes from government interference in business in Europe. A fast moving distribution business can bring about major changes in society that many European governments have not found to their liking. Millions of small store owners all over Europe represent a tremendous political base that one can use, and in any case one is very careful not to upset. Consequently, as we will see later, many European governments have tried to limit the changes in the distribution area to protect small stores.

The second major difference comes from the organization of urban centers. Heavily concentrated cities do not always lend themselves to changing the distribution business because of foot traffic patterns, zoning laws, building problems, etc. Much like there will always be many small food stores in Manhattan or in San Francisco, the same can be said for many European cities.

Last, but not the least, unions in Europe are very powerful, even more than in the United States, and heavily politicized (usually left leaning). They have been a big barrier to progress in the distribution business. In Belgium, for instance, a major department store was closed in downtown Brussels a few years ago because the union would rather see the store closed than allow cuts in the workforce. In many other countries the store would even have had difficulties closing because the government would have prevented any firing at all. In Belgium again, if you want to relocate a store to new and better premises, even if it is 500 feet away, you have to get the union's permission. If you do not get it, as often happens, you are stuck. In France one major distributor was telling me last week that he has 10,000 more workers than he needs in the stores. He cannot cut the workforce because he must get government permission to do so, permission which is not often granted. In Italy many operators who could double the size of their stores or plants easily do not do so because they know that every new employee they hire is there for life. It is almost impossible to fire employees if things go wrong.

This is why many distributors think twice before moving too fast in any direction. It does not mean their position is static. It only means that it is much more difficult to answer the consumers' needs in Europe than here, much more expensive and time consuming to realize what you think is best.

After this very positive situation analysis let me be more specific. Once upon a time in Europe, when you had to shop for food it was necessary to go to the bakery shop for bread, the butcher shop for meat, the produce shop for fruits and vegetables and so on. You frequented these stores on a daily basis. This was the case twenty years ago. Even if it is still the case today, the whole business has changed dramatically. Self-service stores started appearing in the sixties, at least on a larger scale basis, and have grown quickly ever since. In France for instance, supermarkets and hypermarkets accounted for only 2.1 percent of total food sales in 1964. Now, twenty years later, they account for a third of sales, and it would have been considerably more had not the government intervened to stop their growth. In Spain, not one of the most innovative countries in Europe, self-service food stores represent only 11 percent of the 112,000 food stores but account for 51 percent of total sales. And so on, the same story could be told for other European countries.

How come then, small and specialized food stores are still that important today in Europe, albeit much less so than used to be the case? It is a consequence of environmental elements as I mentioned earlier, but to be honest it is more a direct consequence of government protection. Had not it been for that, supermarkets and larger stores in general would be almost as prevalent by now as they are in North America.

When hypermarkets were first established, they could operate on a gross margin, on average 11 points lower than traditional food outlets. In some departments it was even more. Thus they took the European countries by storm. A huge price difference, a huge assortment, a huge selling area did the work. In the center of cities it was difficult to make money with a 20,000 square foot store. In the corn fields, outside cities, you could make it with a 200,000 square foot store. It took off with a bang. In one year only, between 1969 and 1970, larger food stores in France jumped from 7.6 percent of market share to 11.1 percent, gaining 3.5 points of total food sales. Corn, wheat and barley were being replaced by huge selling factories. On the outskirts of many cities two, three and sometimes four hypermarkets ranging from 50,000 square feet to 250,000 square feet would appear almost at the same time. It was the new California gold rush. Distributors would grab desirable sites at any cost, before somebody else did. Up to that point, you could rightly say that this is the typical North American way of doing things, and with good reason. It was the case and it was a good thing. Unfortunately, all good things come to an end, as they say. At the time when consumers were asking for more of these stores, the governments, in their infinite wisdom, decided that enough was enough, that it was against nature to see small stores close and that the population would be much better served by lots of small stores. It is common knowledge that political considerations were never a factor in this case. Only the good of consumers was being taken care of.

Distributors became victims of their own success. Hypermarkets and larger supermarkets had been so successful that the governments decided to limit their development. This success coincidentally happened all over Europe at the same time, on or before the mid seventies. Armed with legislative powers, European governments started hitting back. It was war, and of course the governments won.

It was the "loi Royer" in France, Bill 456 in Belgium, the equivalent in Italy, Germany, Spain, Switzerland, etc. All of these laws had the objective of preventing the future growth of modern stores, when this growth was at the expense of older, smaller outlets.

In France, for instance, as is still the case today, when you wanted to build or enlarge a store you had to get permission from a local board. You are exempted if you are building a store smaller than 10,000 square feet in cities and 4,000 in rural communities. Above that, you have to beg. To make things efficient, the board is usually composed of local leaders such as merchants, municipal councillors, many of whom are merchants or linked to merchants, and a vast array of other local people, including civil servants. It is obvious that when you make a presentation to the board to build a large store that can affect sales of local existing stores, your chances are quite limited, to say the least. Even when you try to be nice, such as offering to integrate local stores into the shopping plaza, when there is one, it often does not work.

As a result, almost three-quarters of the projects submitted are rejected. It is possible to appeal the decisions to the Department of Commerce, but here again the results are usually the same, with even more projects rejected.

Obviously, some projects fly, but not many. While almost 300 hypermarkets were built in France in four years between 1969 and 1974, less than 200 have been built in the ten years following 1974. This slow growth was not because of saturation; there is room for plenty more.

As I said earlier, the same thing happened all over Europe. Distributors for years now have been frustrated because innovation and expansion is so limited. At the same time, many make huge amounts of money because if they have a big store in one area, they are not too worried about the possibility of seeing a competitor build one on the other side of the street, since this competitor will probably not be allowed to do so. Since they are making money the governments then intervene to limit the margins. It is a vicious circle.

To grow, distributors then look in two directions. First, they purchase each other, at the retail and the wholesale level, leading to more and more concentration. Second, they look to the outside world and they see many countries with antiquated distribution systems or just plain good opportunities. This is why the European distributors, particularly the French, British, Belgians and Germans are becoming more and more multinationals in the scope of their activities and in years to come will be to food distribution what the Japanese are to cars. The French, for instance, are a major driving force behind the development of modern food distribution systems in Spain, Brazil, Africa, the Middle East and are even looking to Japan. The Germans, British, Belgians and French are also becoming well established in the United States, the land of opportunities as they see it. As a result, foreign companies now control more than 15 percent of total retail food sales in the United States, and this percentage will grow. Delhaize, for instance, a major Belgian distributor, is making a killing with the purchase it made a few years ago of two good regional chains in this part of the United States, around Atlanta.

And they have nothing to fear. North American food distributors are not crowding the hotels in Spain, the middle East, or Brazil, to establish their own operations. Stockbrokers in New York or Toronto are better at recommending the purchase of so-called high flying high technology stocks on which they alone make money, when mostly foreigners recognize the strong underlining value of many North American food distributors.

These and other reasons lead me to believe strongly that the situation will not change. I do not know one of the major European food distributors who is not right now doing something or looking to do something in the United States. It is a stampede. I know of at least four major French food distributors who are dealing right now with the leading U.S. food wholesaler. Pan American, TWA, Air France and others are bringing to the United States daily loads of financiers, consultants, distributors, all scouting to get a foothold for European food distributors here. It is a stampede in the United States, but also in other countries.

How do they compare as operators? How are they running their stores in Europe and how will they try to do it elsewhere? There are several differences, but the major one to remember is that, even though they have had tremendous government and union constraints, they still manage to be low-cost operators. Margins in Europe for stores comparable to U.S. stores are several points lower. They do it by having a more balanced assortment (for instance, fewer "me-too" products in the grocery department), which is good. They do it by pressuring the suppliers more, which is bad. Chains do it but participating also are large wholesalers and coop groups.

Now you could ask what the independents did to react to the introduction of large stores, since capital costs almost guarantee that big stores were developed by large, well financed chain operations. Well, they did like they do everywhere. At first they were at a loss. They clamored for control laws and they got them. It gave them plenty of time to organize better. Now you will find in Europe very good coop or voluntary groups of independents similar to what we have here. Independents are now holding their own better, because of their own doing instead of through protection afforded by the law. They are not, however, asking for the laws to be repealed of course.

As a result, regular supermarkets, the domain of independents, have been growing very fast in Europe over the past few years, when hypermarkets have not grown as fast as they could because of limits. Many of these supermarkets have been established by local independents, either by enlarging existing stores or even building new ones.

These stores also meet better the new consumer needs of the eighties. They are smaller, closer to the population, easier to get to and to use for the modern, hurried shopper than are the huge hypermarkets. Now hypermarkets are not finished. They are still gaining market share. But supermarkets are taking over with a great impact on older local stores.

The same scenario is repeated all over Europe. In terms of management the Europeans are now up to par and their stores are as well tended and managed as the better North American stores. It does not mean they do not look to the United States for help. As a matter of fact, they are always searching here for new ideas and new ways of doing things, and believe me they take advantage of the information provided, exactly like the Japanese do. It would be so nice if we North Americans did the same thing in Europe. Often distributors could learn in Europe more than they now think.

Enough for Europe. How about food distribution in Canada? In a way it is very much like the United States, and in another way it is very different. Consumer evolution in Canada is the same as it is in the United States, with the resulting impact on store formats, assortments, pricing, etc. The difference lies more in the structure and the conduct of the industry.

Again the environment is somewhat different from the United States, particularly regarding government activities. For instance, anti-trust laws are not working efficiently in Canada. You may say it is the same in the United States. However, you should see our Combines Investigation Act. It simply does not work, whereas the combination of Sherman, Clayton and Robinson-Patman Acts in the United States sometimes does work. Even though I am not particularly keen on government intervention, as you may have noticed, one has to recognize that for instance limiting discounts to the carload as is done in the United States is not a bad idea. In Canada there are no limits on discounts. This has fostered the creation of huge buying groups whose only objective is to squeeze manufacturers as much as possible by pooling volumes. Competitors get together, establish a group, get bigger discounts from the manufacturers when in essence nothing has changed. Life is not easy for food manufacturers in Canada.

Partly as a result of this and other reasons, concentration levels are now very high in Canada. The seven leading food distributors (composed of chains, wholesalers, and groups) now control at least 80 percent of total food sales. In each region, between three and four of these seven firms control at least 80 percent of total food store sales. No need to mention that barriers to entry into the market are incredibly high.

When you take into account the fact that we Canadians have established a wonderful government institution called FIRA (Foreign Investment Review Agency) you will understand. FIRA's objective is supposedly to screen foreign investment so that it benefits the country. In reality, it is a good way of keeping competitors out. Safeway is in Canada, but was there a long time before FIRA. No others can come in.

Now competition does exist. It is quite keen among the major players, but, except for Ontario, it is not as keen as is often the case in the United States. Supermarkets are the rule; discount food stores the exception.

Chains hold half of the market, independents the other half. Independents are growing faster than chains, for the same reasons they grow in the United States--that is, the absence of unions and the coming of age of good, large, sophisticated voluntary and coop groups providing lots of support and advice.

Because the food market is flat, large Canadian chains are looking to the south, namely the United States. Steinberg, Provigo and Loblaws all have large operations in the United States and look forward to grabbing more.

In Canada they are moving as fast as possible to the superwarehouse store concept, a concept that Loblaws launched a few years ago, being among the first, if not the first, in North America.

I could go on for hours but time is limited. I restricted myself to the major points of difference between the two continents to help you understand the evolution taking place. By now you must understand better that in fact, the food distribution industry in the United States, Canada and Europe is globally moving in the same direction. As a matter of fact, one could say that, except for local legislation, it is all pretty much the same everywhere, or coming to it. And in that context, it would not be bad for business if North American distributors started to look more outside, not only for expansion, but also for ideas. In twenty years Europeans, at least in some countries, went from the middle ages to modern times in the distribution trade, much like the Japanese did with cars and other products. There is a lesson in it and maybe you should look at it more closely.

I thank you for your very kind attention.