KEYNOTE ADDRESS

Food Distribution Research:

Our Challenges and Responsibility

by

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I was pleased to accept your invitation to address this 25th annual meeting of the Food Distribution Research Society. I knew I would see a number of old friends in the audience.

Your program looks exciting. In the next two days, you will be dealing with a number of the major issues facing food distribution. Frankly, I am not sure there is a need for me. The program committee has done an excellent job of identifying the issues.

Obviously, I cannot top the list of emerging issues. What I would like to do, instead, is to talk with you about the research challenges that those issues portend--to talk with you about the responsibilities we share as industry analysts in this environment. My comments apply to all of us, whether employed in the industry, either directly or as consultants, or outside the industry working for the public sector.

For those who don't know me well, I should tell you at the outset that I have a very healthy respect for public sector food industry research. My experience as a food industry analyst at Purdue, VPI and USDA and my time in Washington in a policy role taught me two important lessons about this industry.

First, public sector interest and involvement in the food and farm sector is a fact of life. We are not likely to see, anytime soon, a reduction of either the interest or the involvement. Nor should that necessarily be a goal. Second, the people who do the studies--whether at universities, USDA, or elsewhere in government--are in the main, hardworking, dedicated and talented people. Generally speaking, they want to do their jobs well and work hard to achieve their personal and professional goals.

The past three years, as a corporate economist, have also taught me something. I have learned how important it is to walk in someone else's shoes--to experience what they experience--before you attempt to change or even describe what they do or why they do it. I have also learned that the people who work in the private sector--those who make the decisions that influence the overall performance of this industry--are, in the main, hardworking, dedicated and talented people. They, too, take their responsibilities seriously--both in their firms and in their communities.

The Research Responsibility

Perhaps surprisingly, these introductory comments not only have something to do with the subject I have been asked to address--they have everything to do with it. The fact that food industry concerns are public concerns means that the work we do as a profession does get noticed.

I know of no other industry where day-to-day business dealings get so much public scrutiny.

-- Farmers routinely turn to the public sector for political solutions when they believe prices are "too low."

-- Consumers routinely turn to the public sector for political solutions when they believe prices are "too high."

-- Firms routinely turn to the public sector for political solutions when they believe the marketplace is "unfair."

Frequently, in this environment, public sector research--often economic, but just as often technical--is used to build the case for changes in public policy. The influence our work has on public policy and, ultimately, on economic performance in the sector, carries with it important responsibilities.

We must be certain, each one of us, that our research findings and, as important, our judgments, are based on:

-- accurate interpretations of the industry as it is, not necessarily on how we would like it to be. Reality, not perception, must rule our work.

-- completeness. Partial analyses are no longer good enough, if they ever were. For example, we cannot talk about mergers and acquisitions without also talking about store closings, bankruptcies, and business failures. We cannot talk about prices without also talking about costs. We cannot talk about packaging without talking about consumers.
And we cannot talk about technology without also talking about adoption.

-- an all-consuming recognition that, in the final analysis, the food distribution industry exists for consumers--not for farmers and certainly not for firms or individual competitors. We must admit up front that, as scientists, consultants, or even firm managers, we can never know what is best for consumers. The only true test is the test that comes about through the exercise of free choice in the marketplace.

The fast pace of change that characterizes the food distribution industry today makes doing analysis under those conditions difficult. But, so too, do our "typical" research methods. Most of us make judgments about the future based on our understanding of the past.

-- Historically, an X percent change in slaughter results in a Y percent change in prices.

-- X is a high level of concentration in a market because historically it has been Y.

-- Placing this product in this position in this store will result in X percent higher sales because that is what generally happens.

-- Placing this new technology in operation will produce savings of X percent.

-- Don't put a store on that site or in that neighborhood because, historically, firms have not been successful in such areas.

All are examples of judgments (recommendations) based on generalized understandings of the past. All of them likely to be specifically wrong in today's food distribution marketplace--not because the history is factually incorrect, but because the underlying forces that caused the historical perspective have either changed or were not understood in the first place.

Let me be more specific about our research responsibilities by discussing the topic within the context of your conference theme.

Change is the Norm

The food distribution industry is in a constant state of flux--it is now, and has been since man planted the first seed. Change is not new to this industry. But, trite as it may sound, it is becoming increasingly difficult to define reasonable boundaries for this industry.

The industry is becoming more specialized and less specialized at the same time.

- -- "grocery stores" sell considerably more than food,
- -- "department stores" are now part of the food distribution network,
- -- "food stores" have sit-down, white tablecloth restaurants,
- -- gourmet stores sell only jelly beans,
- -- gas stations are becoming convenience stores, convenience stores are becoming gas stations.

And this list could go on . . .

In this setting, how can anything meaningful be said about the structure of the food distribution industry using data from the 1977 Census of Retail Trade? How can meaningful conclusions be made about "real" food stores sales by dividing those sales by the food-at-home CPI? How can we continue to measure productivity in terms of pounds sold? How can one make meaningful statements about market share when it is not clear what the market is?

How can anyone possibly conclude that this is a no-growth industry?

While population growth is indeed slowing, there is no reason whatever to conclude that the industry must stagnate.

First, percent changes in population growth do not produce sales--people do.

In the early 1950s, the U.S. population was growing about 2 percent per year--we were adding about two million people per year to the total population of about 160 million.

In the past five years, the population has grown an average of about one percent, but we are still adding about two million people per year to the total population base.

Second, the population is not static. Food retailing is a service industry. The movement of people creates opportunities for all of us in the industry.

Some firms will improve their lot by moving with the population. Others will find their financial positions improved as firms leave the slow growth markets where they do business.

Third, the industry is not static. Theodore Levitt once wrote that the railroad industry (passenger) failed because its executives ill-defined its industry. They thought they were in the railroad business when they were really in the transportation business.

We cannot--indeed in most cases, are not--making the same mistake. The commitment to the combo store with its wide range of food and non-food items, the constant experimentation with store formats, the emphasis on technological advance, are all clear evidence that we have expanded our view of who we are and who we serve. Our industry is evolving to include a great deal more than food.

Failure to recognize this change is not only dangerous within the firm, but is potentially dangerous to industry growth through its influence on public policy. Those satisfied with the status quo--those who do not want to participate in the evolution of this industry--can be expected to seek protection from governmental bodies. Government anti-trust agencies who continue to use old definitions and old understandings of the market when making judgments about performance in a new and dramatically changing setting will constrain, not facilitate, the industry's growth.

Demographics

Obviously, it does not take a genius to observe that the fundamental nature of this industry is changing. What is not so well understood is why it is changing or what it means.

Frequently, we are told "demographics" is the explanation. No doubt, that is part of the reason behind the changes we are seeing. However, I am reminded of one of my favorite movie lines--it's from *The Graduate*. Remember the pool party where the guy walks up to Dustin Hoffman and tells him in a whisper that the future is to be found in plastics--"plastics, my boy!"?

The operative word today in retailing is "demographics--demographics, my boy!"

Let's share a secret at the outset--we have always had demographics. While the demographic profile of our customer base is changed relative to the 1960s, and even the 1970s, that change is no more a problem and no less an opportunity for retailers than it has ever been.

Demographic marketing is just common sense retailing--successful retailers have always had a reasonably good understanding of who their customers were.

To be sure, I am not against common sense retailing. I am not against demographic marketing.

But the demographic research I have seen, more often than not, is correlation, not causation. Those of us with research backgrounds ought to understand--and help make it more clear--that correlation without causation tends to produce inappropriate policy recommendations in both the public and private sector.

Some things are clear--as the Zayre executive said in a recent article in the *Wall Street Journal*, "people who live in high-rise apartments do not need lawn mowers."

But others are not so clear. Historically, the consumption of fresh seafood has been low in the Midwest. Do you decide, therefore, based on demographic correlations, not to put seafood shops in Midwestern food stores? Suppose you ask a random sample of Midwesterners whether they would like a seafood shop and they tell you "no"--would you necessarily recommend, therefore, not to put seafood shops in new stores in the Midwest? I am not so sure I would.

Much of what is written these days about demographic marketing is extremely shallow. As an economist, I am not bashful about making that criticism. The operative word in the 1970s was "econometrics." We convinced people we could model the economy and predict the future, with decimal point accuracy. Most of that work, while mathematically complicated, was extremely shallow. It did not work. Now, as a profession, we face a serious credibility crisis. I can only hope that today's demographers and market researchers will learn from our mistakes.

At Kroger, we take a great deal of pride in our consumer and market research programs. We believe that satisfying customers is the key to retailing success and we try to operate every one of our stores based on that understanding. But, as is always the case, there are trade-offs. Many of the efficiencies that came with standardization will begin to erode as attempts are made to respond to segmentation--as attempts are made to merchandise each store to a unique customer base.

Thus, the changing nature of food distribution carries with it cost implications, as well. The technical efficiencies that have been so much a part of our history (transportation, warehousing, packaging, large scale processing, etc.) were dependent upon standardization. The emerging realities of the marketplace require segmentation and differentiation.

I suspect that those of you who make your living looking for ways to improve technical efficiencies in food distribution find life quite frustrating in this emerging environment. That is, unless your efforts are responsive to these new realities in the marketplace.

The Technological Revolution

The second set of emerging issues I see for food distribution research result from the technological revolution that is under way.

I do not need to be too specific about the visible signs of this revolution. They will be a big part of your discussions later during this conference.

-- The advent of the personal computer

-- The continued evolution of scanners, including those that talk to customers

-- Office automation

-- Electronic marketing

-- The electronic transfer of funds

-- Etc.

This technological revolution will produce the marketing efficiencies of the 1980s and 1990s.

There are, however, two points I want to make about this revolution and its relationship to food distribution research.

First, to restate a point I made earlier, retailing is a service industry--consumer satisfaction is the key to success. Technological efficiency is important, but it is secondary to consumer satisfaction.

Second technological innovation is a product of the human mind, whereas technological adoption is dependent upon human acceptance.

Scanning is perhaps the best example we have. In numbers, Kroger is an industry leader in scanning. The "hard savings" that are supposed to come from the adoption of that technology are well known in this room. But simply putting scanners in stores does not produce those hard savings; that's only the first stage of the adoption process. In many markets, item pricing remains a sensitive political issue. That limits adoption. But more often, the constraints to capturing the hard savings are our problems--for we are human too. We, too, have to learn how to shed the past and let the future unfold.

Simply put, technological innovation is now far ahead of our human capability to absorb, understand and adopt. That is nothing new. The important thing to remember is that it is not the inventing, but rather the adopting, that produces cost savings. That should not surprise anyone in this room.

Think about how inefficient this meeting really is. Clearly, the technology now exists for none of us to be here today. We could have exchanged all this information with electronic devices. Yet, we are all here--up close and personal!

Last year, I was the chairman of a professional committee of economists. I decided to break tradition--to forego the typical face-to-face meetings in Chicago, New York or Atlanta. My idea was to adopt an exciting, cost-effective technology--the conference telephone call! To say the very least, the resistance to my plan was very surprising.

Why is it that those of us in the business of technological innovation expect so much more from others than we do from ourselves?

The simple fact is, whether we like it or not, the adoption of available technology is an evolutionary process--there are very few revolutions; particularly in retailing. As analysts and scientists, we must focus as much attention on the adoption process as we do on innovation.

The Personal Computer

Frankly, I have an even deeper concern about technology and its place in the management environment. The widespread availability of the personal computer is symbolic of that concern. Personal computers are fast becoming an office status symbol. If you do not have one, your career is suspect. Never mind how you might use it to do your job better.

If it stopped there, I would not be concerned--but it does not. "User friendly" software now makes it possible for everyone to do sales forecasting, financial analysis, and sophisticated cost comparisons. DPP (direct product profitability) is running a close second to "demographics" in the trade press these days! I am not only concerned that these new machines are diverting attention away from thinking (the real function of managers), but also that they are being misused.

The point is a simple one--most handguns are "user friendly," yet we do not randomly pass them out to untrained people. Statistical analysis is not the same as adding and subtracting. Yet, "user friendly" software lets you think it is.

Let me illustrate. A couple of weeks ago, someone came to me with a forecast. Pride was written all over that person's face--after all, the forecast had been done on a P.C. I asked to see the model that generated the forecast. Regression, it turns out, was the tool being used. The parameter estimates looked "funny" so I asked to see the data. A data entryerror--actually a modeling error--had made the matrix singular. Those of you who understand regression know that it is supposed to present a statistical problem--the regression is supposed to "blow up." But, how do you tell someone, via the computer, with no training in statistical analysis, that his matrix is singular. If you tried, the program would not be "user friendly." So, the problem is solved by ignoring it. Data transformations, unknown to the user, allow the regression to be completed in spite of the problem.

What happens when routine management decisions are made with models that come from such a weak analytical base?

Simply put, our collective responsibility as researchers in this society goes much deeper than developing software and showing people how to use it. We also have a training responsibility.

The External Environment

The third set of emerging issues I see for food distribution result from rather significant changes in the external environment--in the general economy.

Wide swings in economic performance are now the norm, not the exception.

The fact is, the performance of this industry, like all other industries--is influenced by the financial condition of the consumer. The record since World War II is clear. In periods of economic expansion, the industry tends to prosper; in periods of economic contraction, the industry does not do well.

Forgetting about ancient history for a moment--the four most recent periods of disappointing profits have all occurred in times of economic weakness:

1966-67, 1970-71, 1975-76, 1982-83

The economy-influenced performance pattern is different for food retailing than for autos, steel, or even retail department stores, but it exists and is quite systematic.

As an industry, we tend to perform best in the latter stages of an expansion and have our biggest performance problems during the late stages of a recession and the early part of a recovery.

Someone told me recently that conditions in the general economy are a more important influence in our industry than used to be the case. It is true that the relative shift toward more general merchandise, the increased volatility in food commodity prices and the dramatic rise in interest rates would appear to make it so.

But, fundamentally, I do not think that conditions in the general economy are any more important than they used to be. I think they are more important than we used to think they were. While subtle, that's a big difference.

Now that we better understand the role of the general economy in our business, changes are in evidence all around us.

-- Managing the food portion of the business is getting more attention, not less. Ways are being found to reduce the volatility of product costs. Procurement is getting more attention. For the first time, I sense a general concern in the food distribution industry about farm policy decisions. I believe that the food distribution industry will participate in the 1985 Farm Bill debate.

-- Financial aspects of the business are getting a great deal more attention. Firm managers are increasingly challenged to learn more about inventory control, gross profit generation and selling costs. Item, department, and market profitability are center stage concerns. For those of us with an economics or finance background, life has suddenly become a lot more interesting. In many cases, it is "back to the basics" of planning, execution and post-analysis. Food industry firms are really trying to do a better job of understanding and then managing in the environment they face.

-- Labor and management productivity are getting increased attention. In spite of all the labor-saving technology, the number of persons employed in the food retailing industry has continued to rise. Wage costs as a percent of sales have risen steadily over the past decade. Labor productivity has been declining to flat. That situation will change.

Simply stated, there exists today, in many markets, a pool of persons, both willing and qualified, to work in food stores at wage rates and under work rules substantially different from those that now exist. The ease of entry in food retailing means that those labor resources will be tapped. And that eventually, labor costs as a percent of sales will decline. The competitive nature of the industry will assume that those savings get passed on to consumers.

Management productivity is also getting attention. Functions are being questioned as are management organizations. The focal point is changing from one of dictating to the "field" to one of honestly asking what can we, at this level of the organization, do to make things work better?

The survival challenge for existing firms in today's food retailing environment is clear: regardless of the institutional rigidities, ways must be found to narrow the gap between potential and prevailing costs in all phases of the business. The higher cost firms will only survive if consumers indicate (through purchases) that they prefer those firms because of the "value" that they deliver. Either way, consumers, and not firms, will dictate the structure that evolves.

That evolutionary process will very likely continue to hurt some competitors (new and old) and some people now in the labor market. There is nothing new about business failures, either in the economy generally or in our industry specifically. While painful for some, it is a process that is essential to the market system. If, collectively, we want the benefits that come from competition and economic evolution, then we must be willing to tolerate, as a matter of public policy, those situations where some individuals and some firms are forced to pay for their failure to adapt to changing times.

The prevailing economic forces in this industry suggest two conclusions about the future of food store ownership. First, the food retailing industry will continue to be characterized by a wide range of ownership types unless, and until, one or more ownership types evidences a clear economic advantage to the consumer. Second, in today's setting, it is not at all clear which ownership type or store format, if any, has clear economic advantage to the consumer. Indeed, the new emphasis on segmentation may well proliferate store formats and ownership types.

Conclusions

I have touched on three forces that help define the emerging issues in food distribution:

1. The constantly changing nature of retailer outlets for food commodities.

2. The pace of technological innovation and adoption, both at retail and in the office.

3. The increased variability of the external economic environment.

As researchers in food distribution--whether from the public or private sector--these forces will influence the things we study and the way we study them.

I believe, as I said at the outset, our most serious professional challenge in this environment is that our work be based on:

-- accurate interpretations of the industry as it is--not how we would like it to be

-- completeness, partial analyses simply do not get the job done, and

-- an all-consuming recognition that this industry exists for consumers.

When all is said and done, the performance of any industry must be judged relative to two standards. First, does the industry exhibit, over time, a responsiveness to changes in both consumer demand and potential costs of doing business? Second, do actual changes in the cost of doing business get passed on to consumers?

By these standards, there can be no disagreement. The food retailing and wholesaling industry in the United States has an outstanding performance record. The changes that have taken place in food distribution--in the way Americans shop for food and other consumables--since the Second World War, are well-known. The fact that these changes have taken place while net profit margins of food retailing firms have declined--from about 3 percent in the 1950s to less than one percent of sales in the 1970s and 1980s--is a part of the story too infrequently told.

Food distribution research has played a part in shaping that story. I have no doubt that it will continue to do so in the decade ahead.