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What Is The Future For Independent Supermarkets?

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Independent food retailers have been losing sales to food-store chains (firms with 11 or more stores) since the 1920's. Independents' share of industry sales fell an average of 0.6 percent each year between 1930 and 1977, and this decline may continue during the 1980's, although independents will always occupy an important place in the industry. Several factors could affect their ability to compete with chains in the future.

Organize for Survival

An independent is a grocery store firm that operates 10 or fewer stores. During the 1930's, independents came up with three major defenses against chains. First, they persuaded some States to enact laws that taxed only chains, but these were soon overturned by the courts. Second, they introduced supermarkets—self-service shopping in stores with plain decor and few customer services—that consumers readily accepted during the Depression. The chains copied the supermarket concept and had the resources to build large numbers of such stores after World War II. Today, supermarkets account for more than 75 percent of total grocery store sales. Third, independents began affiliating with wholesalers to match the product procurement benefits and economies in distribution that chains gained through direct ownership of wholesaling facilities. This affiliation became critical to the independents' survival. Virtually all independent supermarket operators are affiliated with one of about 450 such wholesalers in existence today.

The disappearance of independents also threatened the survival of the wholesalers, so they made substantial changes to tailor their products and services to meet the retailers' needs. Franchising and other contractual arrangements and cost-plus pricing programs—a percentage markup is applied to an entire order rather than to individual products—offering volume discounts were instituted to encourage retailers to concentrate their purchases with one supplier, thereby lowering per-unit warehousing and delivery costs. Wholesalers also offered



numerous business services, such as accounting, group advertising, suggested prices, merchandising ideas, and employee-training programs, that better enable the independent retailers to compete with integrated chains.

These wholesalers also affiliated with larger private label wholesalers, such as IGA and Shurfine, that sell private label products to other wholesalers or to small chains rather than to individual stores. Private label wholesalers develop logos, prepare product specifications, conduct quality control checks, and arrange to purchase merchandise from private label manufacturers, some of whom also sell advertised brands. Private label wholesalers are large enough to gain efficiencies that enable them to offer a wide assortment of food and nonfood products that, in some instances, may rival the selection offered by the largest chains.

The Long Decline

In spite of these efforts to compete with chains, the independents' share of industry sales fell continuously from 70 percent in 1930 to 65.6 percent in 1948, 48.6 percent in 1967, and 40.3 percent in 1977. A more thorough examination of the data shows, however, that many independents prospered. Several became small chains with 11 to 100 stores whose share of sales rose from 7 percent in 1948 to 19 percent in 1977. The share of total grocery store sales by independents operating 2 to 10 stores also increased from about 7 percent in 1948 to 11.7 percent in 1977.

Thus, the decline of the independents was limited to single-store operators. Their share of sales fell dramatically from 59 percent in 1948 to about 39 percent in 1967 and 28.6 percent in 1977. Although many independents were forced out of business by competitors, the fact that the decline occurred over a long period of time suggests that many others went out of business when the owners retired or found more attractive business opportunities.

In contrast, chains' share of grocery store sales grew from 34.4 percent in 1948 to 59.7 percent in 1977. Chains largely dominated new store construction in the suburbs during the past 30 years, while independents have generally obtained stores formerly operated by chains. Today, independents are strongest in small cities and towns that often are not served by large chains. In 1972, a single-store operator ranked among the four largest grocery store firms in 27 smaller U.S. cities.

Paradoxically, independents often are more profitable. According to an earlier report on economies of scale in food retailing, between 1971 and 1978, chains' pre-tax profits averaged 1.2 percent of sales. Affiliated independent retailers' profits averaged 2 percent of sales, and the profits of affiliated wholesalers accounted for an additional 1 percent of retail sales. Independents that find a market niche have very healthy profits. However, if all firms pay the same wholesale prices for their merchandise, the independents will have to charge higher retail prices (or have lower expenses) to meet their profit expectations and those of their wholesalers. Data on gross margins (markup expressed as a percentage of sales) indicate that chains' prices, on average, were at least 3 percent lower than those of independents during 1971-78.

Chains' Advantages

Chains have several advantages in competing with independents. They substantially reduce per-unit operating costs by standardizing their product selection, store layouts, services, operating procedures, and prices

Share of Grocery Stores Sales, Census Years, 1948-77

Firm Size	1948	1954	1958	1963	1967	1972	1977
	Percent						
Independents	65.6	60.6	56.0	52.9	48.6	43.0	40.3
1 store	58.8	51.8	47.0	43.1	38.9	32.2	28.6
2-10 stores	6.8	8.8	9.0	9.8	9.7	10.8	11.7
Chains	34.4	39.4	44.0	47.1	51.4	57.0	59.7
11-100 stores	7.0	9.9	11.7	12.6	15.3	17.4	19.0
101 or more stores	27.4	29.5	32.3	34.5	36.1	39.6	40.7

Sources: 4 and 6.

within (and sometimes across) geographic areas and by tightly controlling individual store managers' discretion. While affiliated wholesalers may perform their functions efficiently, they cannot control retail operations to achieve maximum efficiency. In contrast with the warehouses of chains, independents' affiliated wholesalers are likely to handle more slow-moving products that only a few stores carry, make more frequent deliveries of less than truckload orders, and handle more products by the individual case because the stores they service are not equipped to handle pallets. During the 1971-78 period, chains' warehousing and transportation expenses averaged 4.5 percent of retail sales, compared with 5.1 percent for independents.

Nonpayroll expenses in the store also are lower for chains (6.1 percent of sales versus 8.8 percent for independents during the 1971-78 period). This is largely due to lower store occupancy costs, such as rent, utilities, and insurance, and lower advertising and promotion costs. Although chains advertise more than independents, their advertising costs as a percentage of sales are only about one-half as high. They have an advantage with newspaper and radio and television ads because they can spread the fixed costs of an ad over a large volume of sales.

In addition to cost advantages, chains

often have greater access to the more desirable new store sites, especially choice shopping center locations. Developers prefer to have well-known food chains serve as anchors for neighborhood shopping centers, because chains usually enjoy greater consumer recognition. Chains also have greater access to less expensive sources of financing than independents.

Chains can better afford to employ accountants, buyers, promotional specialists, market researchers, lawyers, consumer representatives, and other specialized professionals because their salaries can be spread over a larger sales volume.

Finally, chains can subsidize strong competitive battles—price cuts and extra promotions—in one area with profits earned elsewhere. Independents, on the other hand, are less able to weather sustained strong competitive pressures and experiment with alternative defensive strategies. Thus, when independents encounter financial difficulties, they often fail.

Independents' Advantages

Independents usually do not try to compete with large chains on the basis of price except on a few products. Rather, they

Gross Margins, Operating Expenses, and Profits, 1971-78 Averages

Type of firm, level of operation	Gross margin	Operating expenses			Pre-tax profits
		Payroll	Nonpayroll	Total	
Percent of retail sales					
Independents					
Store level	19.2	8.4	8.8	17.2	2.0
Warehouse level	6.1	3.0	2.1	5.1	1.0
Total	25.3	11.4	10.9	22.3	3.0
Chains					
Store level	17.8	10.5	6.1	16.6	1.2
Warehouse level ¹	4.5	2.9	1.6	4.5	²
Total	22.3	13.4	7.7	21.1	1.2

¹Includes chains' manufacturing activities.

²Negligible.

Source: (3)

rely on their merchandising flexibility and knowledge of customers' needs and preferences to find market niches created, in part, by the chains' emphasis on standardization. It is not unusual for independents to increase sharply the sales of stores formerly operated by chains.

Independents have the freedom to alter product selection, displays, and prices quickly to meet changing consumer demands and adjust to new competitive pressures. As a result, they have developed a reputation for stressing customer services. Independents also are noted for introducing innovations, especially new store formats and merchandising ideas. Large chains, on the other hand, are noted, for rapidly adopting innovations after they have proven successful. Thus, Bob Holdren observed in 1960 that "independents play the very important role of shaking up the monolithic chains" (p. 23). Recent evidence suggests that independents still play this role.

Independents hold operating costs down by employing nonunion workers and paying lower wage rates. They usually have more

freedom to assign workers to several different tasks and schedule them when they are needed most. Between 1971 and 1978, the store payroll expenses of independents averaged 8.4 percent of sales, compared with 10.5 percent for chains.

Independents' Future Prospects

Independents' prospects are critically dependent on four factors: their share of new store construction, the availability of recycled stores, their ability to preserve market niches, and their ability to compete head to head with chains.

Independents will continue to have difficulty in direct competition with integrated chains, since it is very difficult for them to match chains' prices. They must use variable price merchandising effectively to give the illusion of low prices and cater to consumers' preferences for products and services that the chains do not offer. (For a

discussion of variable price merchandising, see NFR-12.) Some independents have attempted to compete with chains on the basis of price by operating no-frills stores that restrict product selection, provide plain store furnishings, and eliminate some customer services.

However, through the use of computer technology and UPC scanners, chains may be able to gain the store-level pricing and merchandising flexibility that has long been the independents' principal strength. Scanners provide the potential for firms to monitor sales more closely so they can assess the effects of promotional efforts and price changes. For example, prices of some products might be raised without causing a significant reduction in the number of packages sold, and small price reductions on other products might stimulate sharp increases in sales. Scanner data may be useful to compare sales of individual products to the socioeconomic characteristics of a store's customers. Thus, merchandising decisions can be tailored to individual store needs rather than on a regional basis, as is often the case today. Also, by having quick access to sales information on individual items, a firm can more effectively react to other firms' price and promotion strategies.

Many independents have installed scanners, but chains are now adopting them in much larger numbers. Sophisticated analysis of information for marketing purposes most likely will be subject to economies of scale resulting in a comparative advantage for chains. Even if independents match the analytical capability of chains they will lose the merchandising advantage they had when chains standardized their sales efforts among all stores in a market. Independents could find themselves playing catchup in a merchandising game they thought they dominated.

Industry growth slowed during the past decade, prompting many chains to look for new sales opportunities. They are now adding product lines and customer services, experimenting with different store formats, and initiating more aggressive competitive tactics. With the additional merchandising flexibility made possible by scanners, chains could begin to compete more effectively in

the market niches discovered by independents. Some chains also may be vulnerable to other, more aggressive chains.

As new supermarkets get larger, independents find it is more difficult to build stores because of the high costs, difficulty in securing financing and choice locations, length of time and other problems in actual store construction, and increased risk of error.

One of the primary means by which new firms enter the industry (and existing independents expand) is to acquire discarded chain supermarkets. Chains dispose of obsolete stores they cannot operate profitably and do not want to remodel or otherwise try to make profitable. Sometimes chains also dispose of profitable stores, because they lose economies in distribution and advertising in a particular metropolitan area after closing many obsolete stores.

The prospects for continued availability of obsolete chain stores appear good, partly because many chains are replacing some of their stores with large superstores and combination grocery-drug stores. However,

several chains are searching for alternative uses of their obsolete stores, such as no-frills box and warehouse stores. Because of their heavy reliance on recycled stores, independents probably will operate very few of the superstores and combination stores which are expected to become the predominant type of supermarket in the 1980's.

Several chains encountered financial problems that forced them to sell large numbers of stores during the 1970's. Other chains inevitably will encounter financial difficulties in the future, but it appears unlikely that stores will become available at the rate they did during the 1970's.

Wholesalers acquired the expertise to operate supermarkets to meet the service needs of their retail affiliates. If these wholesalers find that their growth and profit objectives are better served by integration into food retailing, they could seriously impair independents' access to recycled stores by acquiring and keeping recycled chain stores, thus becoming chains themselves. Although it does not now appear likely that wholesalers will actively displace

independents in this way, a few wholesalers do operate several stores and must be recognized as potential entrants in several markets. Eight wholesalers now rank among the Nation's 100 largest food chains. Several wholesalers also own a substantial interest in some of their affiliated retail operations.

Conclusions

Conditions appear to favor continued erosion of independents' share of sales during the 1980's. They have been unable to match fully the economies and other benefits that chains gain through multistore operations and integration into wholesaling. The adoption of UPC scanners could potentially put them behind in merchandising flexibility too. Finally, the independents' restricted access to new supermarkets prevents them from entering the new growth areas of food retailing on a par with chains. ■

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Wholesalers Increase Competition and Ease Market Adjustments

Affiliated wholesalers provide services that improve the overall competitive health of markets.

- Integrated chains with their own warehouses would dominate urban food markets if independents did not have the lifeline of products and services provided by affiliated wholesalers.

- Large-scale operation is needed to gain scale economies that contribute to lower food prices. However, when chains gain scale economies they may also gain enough market power to raise prices. Affiliated wholesalers provide a mechanism for

independents to organize into groups to gain scale economies, but it difficult for them to coordinate their behavior effectively enough to raise prices artificially.

- Affiliated wholesalers actively search for new market entrants to replace other independents that either fail or grow into chains and discontinue their affiliation. This process contributes to the introduction of new ideas that help maintain a dynamic competitive environment.

- Finally, affiliated wholesalers minimize the disruption of company failures by recycling the facilities and people back into the industry. Wholesalers often buy stores and operate them until a new operator can be found. Chain failures are especially disruptive because several stores, including profitable ones, are recycled at one time.