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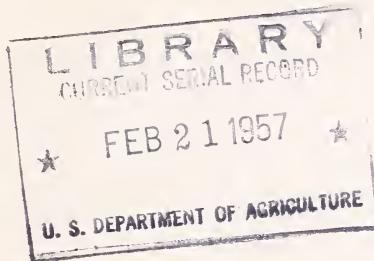
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DO TRADING STAMPS AFFECT FOOD COSTS?

Expansion and Extent of
Use of Trading Stamps

Plan of Operation and
Influence on Patronage

Costs and Economic
Implications



Marketing Research Report No. 147

U. S. DEPARTMENT OF AGRICULTURE
Agricultural Marketing Service
Marketing Research Division

Washington, D. C.

Foreword

Food prices reached a near-record level in the third quarter of 1956. This advance was part of a broad increase in living expenses which reached a new high. Public opinion was focused on the increase and consumers want to know why food costs so much. Studies by the U. S. Department of Agriculture show that more than half of the retail price of food goes for processing and distribution. Because of this, any changes that may result in further increase in costs come in for close attention.

In recent years a number of competitive practices have developed or been expanded at the retail level which may affect the cost of retailing. One of the most striking of these is the phenomenal expansion in use of food trading stamps. Because of the importance of these developments the Agricultural Marketing Service has undertaken a study of the effects of the use of food trading stamps and associated practices on marketing organization, costs, and efficiency.

This first report seeks only to explain the basic characteristics of trading stamp plans, to review and discuss available information relating to the development and use of the stamps, and to consider some of the relevant issues and economic problems facing retailers and consumers as a result of the widespread use of these stamps.

Estimates given here of the volume, costs, value, and other evaluations of stamps are based mainly on the best, but limited, information available from non-Government sources, including industry studies. Subsequent reports will give information on other phases of the problem.

JANUARY 1957

II

DO TRADING STAMPS AFFECT FOOD COSTS?

*Prepared by Market Organization and Costs Branch
Agricultural Marketing Service*

Trading stamps are a promotional device for attracting and holding customers. Although food retailers have long used them to a limited extent, their use has increased rapidly in the last few years and is now widespread over the Nation.

In 1956, more than 400 companies were in the business of supplying trading stamps to retailers of all types in the United States. Sales of trading stamps to retailers totaled more than 600 million dollars. About half of all families in the United States were saving trading stamps.

These developments have raised questions about the influence of the use of these stamps by retailers of food products on (1) costs of mar-

keting; (2) shifts in expenditures for food to nonfood items; (3) adjustments in merchandising practices of retailers; (4) changes in consumer buying practices and shopping habits; and (5) costs and benefits to farmers, retailers, and consumers.

Trading stamps of the modern type originated during the 1890's. The trend in volume distributed was upward most of the time during the next 60 years, but has expanded rapidly since 1950. The present inquiry deals with the immediate and longer time influences of the use of trading stamps on prices of and marketing costs for food and other products.

Plan of Operation

A common plan of operation is for the retail merchant to buy trading stamps in bulk from a stamp company and distribute them to customers as a means of attracting and holding patronage. Other arrangements involve store-owned stamp companies, cooperative stamp companies, individual store stamp plans, and cash register tape plans, among others (9).¹

Each stamp company usually supplies stamps to only one retailer of a given type in each trade territory, this territory usually being large enough to permit considerable expansion in volume of sales. The stamp company also provides advertising materials and promotional aids, as well as other assistance in operating the stamp program. The supplies include books in which to

save stamps, and premium merchandise catalogs. Premiums to be distributed to customers in redemption of stamps are also furnished by the company.

Total charges made by stamp companies to retailers for the stamps, suppliers, and service usually range from \$2 to \$3 per 1,000 stamps, or two- to three-tenths cent per stamp (1, 4, 5, 9). The retailer usually distributes to a customer one of these stamps for each 10 cents' worth of products purchased, although 2 or more stamps are sometimes given. Customers paste these stamps in books usually holding about 1,200 or 1,500 stamps. Such books, when filled, are commonly said to be worth from \$2 to \$4.50 each in terms of retail prices of the premiums offered. Representatives of stamp companies refer to these

¹ Italic numbers in parentheses refer to Literature Cited, page 6.

returns to customers as "a bonus for paying cash," "interest on the money you spend," "equivalent to cash in your pocket," or "a reward for patronage."

Trading stamps may be used to supplement or to replace other promotional devices, such as advertising, low-price specials, coupons, or cash discounts. To the extent that stamps supplement rather than re-

place other promotional devices, both the benefits and the costs to retailers of using the stamps are in addition to those of other forms of promotion. If stamps are used to replace other forms of promotion, the net benefit to the retailer of using these stamps is the difference between the benefits and costs of trading stamps and those of the replaced promotional forms.

Influence on Volume of Sales

Increases in volume of sales attributed to the use of trading stamps have apparently ranged from little or none to 100 percent or more in some stores. The degree of increase varies with the kind of store, merchandising methods and practices used, other promotional practices associated with the use of trading stamps, and competitive devices of other nearby stores.

Data relating to grocery stores in Minneapolis show that increases in weekly volume of sales from early 1953 to December 1954 averaged 41.2 percent for stores using trading stamps, and 8.1 percent for stores not using stamps. Similar data for 121 stamp stores in 5 cities show that increases in weekly volume of sales during this period averaged 34.2 percent (9). But results of a 1954 survey in Denver of 64,400 families who bought most of their groceries at stores giving stamps showed that relatively few of them (2.6 percent) gave stamps as the principal reason for patronizing these stores. Fourteen percent of them mentioned trading stamps as one of the reasons for patronizing particular grocery stores (2).

A more recent national survey (8) of 304 dealers who use trading stamps shows that 80 percent of the supermarkets (food stores with annual sales of \$375,000 or more) and

56 percent of the superettes (food stores with annual sales of \$75,000 to \$375,000) increased their volume of sales. The increases for supermarkets ranged from 3 to 75 percent and averaged 21.3 percent. Increases for superettes ranged from 1.5 to 60 percent and averaged 18 percent. Operators of 85 percent of the 304 stores were competing with other operators who were also using trading stamps. No small stores were included among the 304 stores surveyed, but reference was made to an annual survey of the food trade early in 1956 which indicates that average volume of sales of small stores using trading stamps declined 1.8 percent in 1955 (8).

Changes in sales attributed to the use of trading stamps in food stores for the first half of 1956, as revealed by a nationwide survey, are compared with those of the corresponding period in 1955 (6). For supermarkets, increases in volume of sales averaged 10.2 percent for stores giving trading stamps and 6.7 percent for stores not giving trading stamps. For superettes, the increases averaged 9.5 and 3.9 percent, respectively. Small stores as a group showed a decrease in volume, the decrease averaging 4.4 percent for stores giving trading stamps and 1.2 percent for stores not giving trading stamps.

Influence on Prices and Costs

Whether prices of food products to consumers are increased by use of trading stamps is a question on which opinions differ widely. Interviews with retailers and stamp salesmen in New Mexico and other States elicited a variety of responses to this question. Some salesmen of trading stamps indicated that sooner or later a price rise is usually necessary. Others gave such answers as "retailers should not have to raise prices" and "the stamps pay for themselves by increasing business" (7).

Retailers using trading stamps were cautious in their reports (7). One retailer in analyzing his stamp costs reported that, if these costs were to be passed on fully to consumers, a price rise of 4 percent would be necessary. Of the cost of the stamps, he allotted three-fourths to the stamp company and one-fourth as compensation for added labor and accounting costs involved. Retailers who had not used trading stamps generally believed that they would have to raise prices if they used stamps. Adequate data required for answers to these questions are not available, and they may be difficult to obtain even with the wholehearted cooperation of retailers.

Immediate Influence of Use of Stamps

Immediate increases in volume of sales of food products by retailers as a result of using trading stamps presumably are accounted for mainly by shifts in patronage from competing retailers who are not using stamps. Apparently there is no reason to suppose that the total volume of food products available for distribution, or the quantity consumed at any given time, is affected materially by the use of trading stamps.

Most food retailers apparently could increase their volume of sales

Results of a recent national survey indicate that about three-fourths of the operators of supermarkets and four-fifths of the operators of superettes reported that the use of trading stamps increased their operating expenses (8). Less than 10 percent of the operators were able to absorb the added costs through increases in volume of sale. In attempts to offset the increase in operating expenses as a result of using trading stamps, about 27 percent of the operators increased their gross margins, 43.5 percent used fewer low-priced specials, about 38 percent reduced their advertising, and some used other means. About one-eighth of them said they could not offset the additional costs of stamps by any means. The inadequacy of these means of offsetting the increases in operating expenses of stamp users is indicated by data showing that net earnings of 49.1 percent of the users decreased, those for 30.7 percent increased, and those for 20.2 percent remained unchanged (8). The differences in results reported suggest the need for additional information to show how and to what extent the costs of trading stamps can be offset, and the most effective means of accomplishing it.

without proportionately increasing their facilities and labor force. Conversely, a reduction in volume of sales in many instances would not permit a corresponding reduction in facilities and labor force. Under such conditions, shifts in consumer patronage from one store to another through the use of trading stamps benefit retailers who use stamps, and are detrimental to competing retailers who do not use stamps. Accurate measures of the effects of change in volume of sales on costs of retailing food are not available.

But it appears probable that reductions in per unit costs to stores using trading stamps from increases in volume of sales usually are about the same to somewhat less than increases in unit costs to competing retailers from corresponding reductions in volume of sales. Then, under these conditions, it would appear that the immediate effect of using trading stamps on net incomes of food retailers as a group would be a net decrease in income about equal to or greater than cost of acquiring and distributing the stamps. Any advances in prices of food as a result of trading stamps would shift costs of stamps from retailers to consumers.

Value of Stamps

If prices of food products were not changed as a result of the use of trading stamps, purchasers of these products would be benefited by amounts equal to the value of the stamps received. The value of the stamps to purchasers of food is derived mainly from the premiums obtainable for them, but there may be psychological values associated with the collection and redemption of stamps that are not fully reflected in the market value of the premiums. Stamps usually are exchanged for merchandise, but in some States are redeemable in cash.

Payments by retailers to stamp companies for stamps and related services are designed to cover costs of commissions of stamp salesmen, premiums for the redemption of stamps, and other expenses and

profits of stamp companies. Information available is too limited for final conclusions with respect to the division of these payments. But apparently, the well established stamp companies use between one-half and two-thirds of their receipts from stamps for the purchase at wholesale of premiums for the redemption of stamps. Newer and less well-established companies may operate on much wider margins.

The spreads between wholesale costs of premium items to well-established stamp companies and the list retail prices of these items apparently are such that the value of stamps to purchasers of food in exchange for premium merchandise may equal or exceed costs of these stamps to retailers. In States where discount houses are permitted to operate, consumers may be able to buy premium items below retail list prices. In such cases, as well as special retail sales, the value of stamps to consumers may be substantially less than costs of the stamps to retailers (3). In States where stamps are redeemed in cash, the cash value of stamps to consumers averages about two-thirds or three-fourths of the cost of stamps to retailers.

From a practical standpoint, stamp companies market appliances and other premium items. Whether this system of marketing these items is more efficient than the more conventional methods is an important question in a complete evaluation of stamp plans, but is beyond the scope of this report.

Influence Over Longer Periods

The central management problem of retailers with respect to the use of trading stamps or other forms of promotion is one of making judicious use of promotional funds in strengthening or maintaining their competitive position. The amount of funds to be used and the allocating of them among the various forms of promotion are important

considerations. This problem becomes especially acute for retailers in such areas as Denver, Colorado, for example, where competing firms have greatly expanded their use of trading stamps (2).

Retailers facing loss of business to competitors who use trading stamps may seek to protect their competitive position by themselves

undertaking the use of trading stamps or expanding other forms of sales promotion. In such a case, both groups of retailers would be required to pay the added costs of such promotional activities without obtaining commensurate benefits in the form of increased sales. This could lead to further increases in various types of promotional expenditures by retailers in an effort to strengthen or maintain their competitive position. Under such conditions the total cost of retailing food products would be increased unless the added promotional costs could be offset in some other way. Should total marketing costs be increased by such promotional activities, retailers would either have to raise prices, accept lower profits, suffer a loss, or reduce prices paid to farmers.

The demand for food products plus stamps may reasonably be expected to exceed that for food products alone by the extent of the demand for stamps. Prices of the food-and-stamp combination could be raised above the prices of food alone by amounts approaching the value of the stamps to purchasers of food without reducing the volume of sales of food products. The expenditures representing payment for stamps may reduce the amount of funds available for purchasing food and other items. The extent to which the demand for food may be reduced as a result of such reductions in funds would depend upon the extent of the reductions and on the elasticity of consumer demand for food with respect to income. But the effects of additional expenditures for trading stamps on demand for food are not likely to be great.

If prices of food-plus-stamps were higher than prices of food alone by only enough to account for the average value of the stamps, purchasers of food as a group would be about as well off with as without

trading stamps. However, the users of the stamps who place little value on them would pay relatively more, and those who value them above the average would pay relatively less, than the stamps are considered by the customer to be worth. This may be a case of lack of choice on the basis of the consumer's evaluation of the service or item.

If prices of food-plus-stamps were raised enough above what prices of food without stamps would have been to offset retailers' costs of obtaining and distributing the stamps, retailers as a group would be about as well off with as without the stamps. As indicated above (p. 4), the value of trading stamps to many patrons, especially those that redeem stamps in cash and those that can buy the premium items desired at discount houses, is less than the cost of stamps to retailers. Then, advances in prices of food-plus-stamps sufficient to offset the additional costs to retailers of obtaining and distributing trading stamps would be greater than the cash value of the stamps to consumers. Differences between costs of trading stamps to retailers and the cash value of these stamps to consumers may be offset in some instances by such factors as the psychological value to consumers of collecting and redeeming stamps and increased efficiency of retailers as a result of trading stamps. But, unless the differences between these costs and values are completely offset by these factors, costs to all retailers and consumers of food as a group of using trading stamps would exceed their value to purchasers of food.

Increased competition through the use of trading stamps by some retailers and through price cutting or other means of sales promotion by others—designed to meet the increased competition of users of trading stamps—may force some retailers, particularly the smaller and

least efficient ones, to go out of business. From 1948 to 1954 the total number of retail food stores in the United States decreased about 25 percent and the average number of customers per store and the volume of sales in dollars per store increased about 42 and 76 percent, respectively, according to Census reports.

It is not known to what extent, if any, the reduction in numbers of retail food stores may be attributed to the use of trading stamps. Neither is it known to what extent the increase in trading stamps used may be accounted for by attempts to gain a competitive advantage over nonusers, or to gain a more favorable competitive position in relation to users, of these stamps.

If supermarkets and superettes continue to gain relatively more than small stores from the use of trading stamps (6), the swing of business away from the smaller or less efficient stores to the larger and more efficient ones may be accentuated. Such developments may increase the average efficiency of retailers by increasing the volume of

sales of those that continue in business. Resulting savings may be enough to offset at least a part of the costs of obtaining and distributing trading stamps.

This review and analysis of currently available information has been performed as an essential first step toward undertaking comprehensive research relating to use of trading stamps in food retailing.

The research, now under way, will develop much fuller information on this subject than is now available and thus enable detailed analysis of the impacts of use of trading stamps on costs of food marketing. It will deal with such points as (1) the basic characteristics of trading stamp plans for food products; (2) some of the probable effects of widespread use of trading stamps on marketing channels, costs, prices, and practices; (3) response of consumers to trading stamps; (4) extent to which changes in consumer buying practices will affect the sale of food and the organization of the marketing structure; and (5) relevant legislation affecting the use of stamps.

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