Changing Structure of Produce Buyers—Food Retailing and Wholesaling—and Implications for Suppliers

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Grocery Retailing Channels
• Grocery retail channels are defined to include integrated wholesaler-retailers, consisting of the buying operations of corporate chains such as Kroger as well as voluntary chains such as SuperValu and Fleming, and retail cooperatives like Associated Wholesale Grocers and Certified Grocers of California. Total 1999 US grocery store sales were $434.7 billion, excluding Wal-Mart.

• Mass-merchandisers are Supercenters (a supermarket within a larger general merchandise discount store) and Club Stores (membership wholesale clubs). The Supercenter format is led by Wal-Mart with estimated 1999 grocery equivalent Supercenter sales of $15.7 billion and total Supercenter sales of $39.2 billion, equivalent to 56% of the $69.8 billion 1999 national Supercenter industry sales. In 1999 national Club Store sales totaled $60.7 billion, rather evenly divided between Costco (49.3% market share) and Sam’s Club (also owned by Wal-Mart and with a 43% market share) with BJ’s holding a 6.7% market share.

Mergers and acquisitions among food retailers and wholesalers have contributed to greater concentration levels at the buying end of the vertical food system. As the leading retailers and wholesalers have grown, they exercise greater buying power, including in their procurement of fresh produce. This article highlights some of the recent key mergers and the current concentration levels in the US food marketing system, identifies some of the forces motivating firms to undertake large mergers and acquisitions, and explores the implications for suppliers.

Consolidation in Food Retailing
From 1992 to 1999, the largest four food retailers’ share of grocery store sales rose from 15.9 percent to an estimated 29 percent while the share of the 8 largest retailers increased from 24.9 percent to 42 percent. Most of these gains occurred after 1996, when a number of firms consolidated. Successive acquisitions by Yucaipa/Fred Meyer in the Pacific region, by Ahold in the Northeast, and by Safeway in multiple regions have rapidly increased their size and contributed to higher national concentration levels.

Then in 1998 two mergers took place involving the largest ever combined sales of food retailers. Kroger, the largest retailer with sales of $26 billion in 1997, merged with Yucaipa/Fred Meyer to form a multiregional supermarket operator with $43.1 billion in combined sales. By 1999, the combined firm operated 2,575 supermarkets in 31 States, with convenience stores in an additional 6 States. Also in 1998, fourth-ranked Albertson’s initiated its merger with second-ranked American Stores, resulting in 1999 combined sales of $34 billion, from 1,652 supermarkets in 38 States, making Albertson’s the number two chain. Ahold, the Dutch chain, continued on its acquisition path, acquiring Giant Food, Inc. in 1998, becoming the fourth largest retailer with $23.4 billion in 1999 sales and 1,031 stores.

Today there are ten integrated wholesaler-retailers each with over 1000 stores selling over $1 billion in fresh produce annually. For each of the two largest supermarket chains fresh produce sales are estimated to exceed $4 billion. Clearly, the buying power of these groups is impressive with half of US food sales now accounted for by 10 integrated wholesaler-retailers. Shippers who are not equipped to sell to these very large buyers must focus their efforts on the remaining more fragmented portion of the food system, both retail and other.
Consolidation in Food Wholesaling

Consolidation is also occurring rapidly among merchant food wholesalers—especially among the general-line grocery wholesalers primarily serving food stores and supermarkets, and the general-line foodservice wholesalers primarily serving restaurants and institutional customers such as schools and hospitals. Acquisitions and mergers continue to reshuffle the ranks of the leading companies. Grocery-oriented wholesalers undertook 32 mergers and acquisitions in 1999 and a cumulative total of 105 since 1997.

Supervalu/Rich Foods, a voluntary chain and a type of integrated wholesaler-retailer, is the largest grocery wholesaler, with 1999 sales of $22 billion and serving some 4,400 stores from over 34 distribution centers. In addition to serving independents and smaller chains, Supervalu owns and operates 431 corporate stores. In 1992, Supervalu acquired Wetterau, then the third largest wholesaler, for $1.1 billion. Supervalu’s other acquisitions include Sweet Life Foods in 1994, 58 retail food stores in 1998, and, in 1999, Richfood Holdings. Richfood—upon purchase of the sixth largest wholesaler with sales of $3.2 billion—had been active in acquiring other wholesalers and retailers. It more than doubled its sales from 1994 to 1999 by internal growth and by acquiring the supermarket chains Farm Fresh, Inc., and Shoppers Food Warehouse.

Fleming Cos., the largest wholesaler until 1996, acquired Scrivner in 1994 for $6 billion. Fleming’s sales peaked at that time at $19.3 billion, and have since declined to $15.1 billion. Fleming has 34 distribution centers, and is reducing its buying centers from 57 to 14 as it streamlines operations. It serves over 5,500 grocery stores, and owns 279 corporate food stores and is now the number two ranked wholesaler.

C & S Wholesale has become the third largest wholesaler by aggressively seeking to serve medium to large chains such as Grand Union. Nash Finch has been actively acquiring both retail stores and several regional wholesalers: Military Distributors of Virginia in 1995, Super Food Services and T.J. Morris in 1996, and United-A.G. Cooperative in 1997. And in 1999, two large west coast firms—Certified Grocers of California (sales of $1.8 billion) and United Grocers (Oregon, $1.2 billion)—merged to form the seventh largest grocery wholesaler.

Foodservice Wholesalers

Foodservice wholesalers completed 31 mergers and acquisitions in 1999. Still, the foodservice distribution industry remains relatively fragmented, with the top 50 firms accounting for 28.1 percent of total foodservice wholesale sales in 1997. The top 10 wholesalers accounted for 25.3 percent of the $147 billion in total industry sales in 1998, while the top 4 firms had a 21 percent share. Fragmentation in the foodservice wholesaling industry is because of the huge number of final users served. While there are about 30,600 supermarkets in the U.S. there are over 627,000 commercial foodservice outlets, and around 112,000 non-commercial outlets. In addition, while large retailers predominantly buy fresh produce directly from shipping point, avoiding wholesalers, foodservice buyers still rely greatly on wholesalers and terminal markets.

Sysco Corporation is by far the largest foodservice wholesaler, with sales of $17.4 billion in 1999, up from $14.8 billion in 1997. While Sysco distributes a full line of food and nonfood products, fresh produce now accounts for 6 percent of its sales, equivalent to about $1 billion. Alliant Foodservice, formerly known as Kraft Foodservice, acquired five foodservice distributors during 1997-98, increasing its sales to $6.1 billion in 1999. In 1995, the third largest wholesaler (Rykoff-Sexton) merged with the fourth largest wholesaler (U.S. Foodservice) under the U.S. Foodservice name. Then Royal Ahold, the Dutch retail chain, acquired U.S. Foodservice with sales reaching $8 billion in 1999, moving it into second place. In August of 2000 Royal Ahold’s U.S. Foodservice acquired PYA/Monarch, creating a group with combined annual sales of $10.7 billion.

As consolidation occurs in foodservice channels buyers will procure greater volumes of fresh produce directly from shipping point, just as retailers have increasingly done in recent decades. Since much of the product moving through wholesale markets is destined for foodservice users, as large foodservice buyers grow in importance, wholesalers will need to become more service oriented if they are to retain these customers.

What’s Motivating Consolidation?

Food retailers seek growth through consolidation for many reasons. Slow growth and low inflation rates
in the general economy have limited the ability of retailers to raise grocery prices and margins. Over 1992–99, inflation-adjusted grocery store sales were flat, averaging only 0.2 percent annually. Despite rising incomes, consumer expenditures for food at home continue to fall. From 1992 to 1999, the share of disposable income devoted to food at home (retail food) fell from 6.9 percent to 6.2 percent, continuing a long-term trend. Meanwhile, consumers bought more prepared foods and meals away from home, indicating their preference for convenience and timesavings. Of total spending for all food, 47.5 percent went to the foodservice sector in 1999, compared with 44.4 percent in 1992 and 40.1 percent in 1982. The growth in foodservice spending would be even greater if sales of similar prepared foods sold in food stores were included.

Supercenters operated by discount mass-merchandisers and warehouse membership club stores are additional sources of competition for food retailers. They increased their retail food sales by almost 75 percent since 1992, to reach $65 billion in 1997. Over the same period, food sales by traditional retailers grew only 15 percent.

Hence, stable food prices, slowing growth in at-home food spending, the increasing share of the food dollar spent in restaurants and other foodservice outlets, and the growth of food sales by non-traditional retailers have heightened competition among grocery retailers. Larger food retailers have opted to merge, citing cost savings and efficiency gains in order to better compete.

Implications for Fresh Produce Suppliers
Retailers expect greater efficiencies in the procurement of many products, including produce as a result of mergers. By purchasing more volume, retailers hope to lower the per-unit cost of goods by negotiating lower prices. In return, retailers may develop partnerships with preferred suppliers, concentrating volumes with these firms, potentially benefitting suppliers with more predictable firm level demand. When demand and supply are more closely coordinated buyers and sellers can work together to stimulate sales, and achieve more consistent volumes and quality. On the other hand, as price takers in a low margin business many shippers feel that they have little ability to absorb lower fob prices, reporting that volume discounts are not cost-justified for commodity-based fresh produce shippers (as opposed to shippers of value-added produce like packaged salads).

Retailers also expect reduced marketing and selling costs as a result of relationships with preferred suppliers. Suppliers are being asked to help retailers with the design and provision of category management, effective design of promotions, promotional allowances, and special packaging. To make this type of marketing support function effectively retailers should share sales data with suppliers to better evaluate promotions, seasonal effects, price responses, and other characteristics of consumer demand. However, to date it is mainly the mass merchandisers that aggressively share information with shippers, reducing the effectiveness of supply chain management in conventional retail channels. Clearly, firms on both sides of the retail-shipper interface are still in the initial phases of capturing the potential benefits of partnering.

Although the economic effects of the recent mergers on fresh produce have not yet been determined, many suppliers fear that competition will erode. To date, many recently merged chains are still in the process of integrating their buying systems and some still buy produce on a division basis (with divisions defined along the lines of the incorporated chains), lessening the effect of consolidation. However, this is changing with corporate buying growing in importance at most chains. Grower-shippers will increasingly face fewer but larger buyers as consolidated food retailers reduce the number of buying offices and combine orders into larger volumes. Produce suppliers have also cited new marketing and trade promotion practices, such as slotting allowances and fees, as evidence that produce buyers may enjoy an unfair advantage in bargaining with suppliers (see box).

Still, produce suppliers will be challenged to meet the needs of food wholesalers and retailers that adopt supply chain management practices. Many smaller grower-shippers may form joint ventures, cooperatives, or other alliances to better serve large retailers. Other produce suppliers may seek niche markets, either product- or buyer-derived in order to meet the procurement needs of different sizes and types of buyers. For example,
niche markets exist for specialty fruits and vegetables or organically grown products and independent retailers and upscale restaurants can be profitable niche markets for high quality produce of all varieties.

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Slotting Fees

One of the retail fee types most of concern to fresh produce shippers is slotting fees, where suppliers are charged for access to shelf-space, usually for new products although suppliers may also pay slotting fees for existing products, commonly referred to as pay-to-stay fees. Slotting fees, common to manufactured grocery products, have not traditionally been used in fresh produce departments. Manufactured grocery products are generally available year-round from the same supplier with consistency in quality, sizing, volumes and pricing. Manufacturers are generally not price takers, exercising control over pricing and able to pass along fees to buyers by incorporating them into their pricing and allowance structures.

In contrast, fresh produce commodities are generally produced seasonally, often by different suppliers in different seasons, intra- and inter-seasonal quality and sizing may vary, weekly volumes may be inconsistent, and individual shipper volumes may be low relative to retailer needs. All of this means that retailers often can’t procure all or most of their volume from one or limited suppliers. Furthermore, as price takers shippers have less ability to incorporate slotting and other types of fees into their cost/pricing structures. ERS/USDA, including cooperators such as Cook at UC Davis, is currently investigating fees in the produce industry and will be publishing a report in the near future.