Special Article

Consolidation in Food Retailing: Prospects for Consumers & Grocery Suppliers

In recent years, the U.S. food retailing industry has undergone unprecedented consolidation and structural change through mergers, acquisitions, divestitures, internal growth, and new competitors. Since 1996, almost 3,500 supermarkets have been purchased, representing annual grocery store sales of more than $67 billion (including food and non-food sales by supermarkets, superettes, and convenience stores). Two of the largest food retailing combinations in history were announced in 1998: the merger of Albertson's (the nation's fourth-largest food retailer) with American Stores (the second-largest), and the acquisition of sixth-largest Fred Meyer by first-ranked Kroger Company.

The recent consolidation wave has brought together food retailers operating within and across regions. While many food retailers operate in multiple regions, none is considered truly nationwide in scope. Of the consolidations, the Albertson's-American Stores merger, which resulted in common ownership of supermarkets reaching coast to coast (but not all regions), comes closest to creating a nationwide food retailer.

Widespread consolidation in the grocery industry—driven by expected efficiency gains from economies of size—has had a significant effect on the share of total grocery store sales accounted for by the largest food retailers. It also raises questions about long-term trends driving these changes and the implications for consumers and for food market suppliers such as grower-shippers, food processors, and wholesalers. Some consumers fear that fewer food retailers will eventually mean higher grocery prices and less variety. Grocery suppliers worry that fewer but larger buyers could force prices lower for products and services that food retailers purchase. Retailers are likely to continue consolidating in order to maintain profitability as competition for the consumer food dollar heightens. Whether or not the current pace of consolidation continues depends, in part, on resulting efficiency gains for large food retailers.

Long-Term Trends Drive Consolidation

A number of long-term trends are prompting food retailers to consolidate: changing patterns in overall grocery sales, increased spending for prepared foods and meals away from home, and growth of food sales by nontraditional retailers. These trends make for a very competitive food retailing industry, and with low inflation rates in the general economy, retailers' ability to raise grocery store prices is limited.

Food retailing is a relatively slow-growth industry, as measured by sales. Grocery store sales, after adjusting for inflation, grew about 1 percent annually over the 1988–98 decade—about equivalent to population growth. Over the 6-year period 1992–98, nominal supermarket sales growth averaged 2.2 percent annually, based on research by USDA's Economic Research Service (ERS).

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The share of consumers' income spent for food-at-home, purchased from foodstores and other retail outlets, continued to fall. From 1992 to 1998, the share of disposable income devoted to food-at-home fell from 7.8 percent to 7.6 percent, continuing a long-term trend. With rising incomes, consumers exercised their preference for convenience and time savings by purchasing more prepared foods and meals away-from-home. Of total spending for all food, almost 47 percent was in the away-from-home food service/restaurant sector in 1998 compared with 44.8 percent in 1992 and 40.5 percent in 1982. Growth in food-service is somewhat underestimated in recent years because sales of similar prepared foods sold in food stores are excluded from the tally.

Expansion of retail food sales by discount mass-merchandise and warehouse club stores has provided additional sources of competition in the traditional food retailing business. Mass merchandisers such as Wal-Mart, Kmart, and Target, and warehouse club store operators such as Costco, Sam's (a division of Wal-Mart), and BJ's have increased their share of retail food sales from 4.8 percent in 1992 to 7.7 percent in 1998. At the same time, traditional food stores' share of retail food sales fell—from 84.6 to 80.1 percent of sales. The remainder of retail food sales was accounted for by other retail stores, mail-order outlets, and direct sales by farmers and processors.

The effect of slow growth in real grocery store sales (net sales growth after adjusting for inflation) and competition from nontraditional retailer rivals motivated grocery retailers to seek a larger share of consumers' food dollars. In the 1980's, retailers developed new store formats to better address the needs of specific consumer segments, ranging from warehouse stores serving economy-minded shoppers, to organic and natural foods supermarkets aimed at less price-conscious but more health-oriented

Recent Acquisitions in Grocery Retailing

Retail firm				
Acquiring	Acquired	Year	Grocery stores acquired	Sales value of acquired stores
			No.	*$ million*
U.S. total			**3,492**	**67,103**
Pacific region			**1,284**	**22,269**
Safeway	Vons	1997	325	5,400
Yucaipa	Fred Meyer	1997	101	3,124
Quality Foods Centers	Hughes	1997	57	1,250
Yucaipa	Smiths Food & Drug	1997	150	3,000
Yucaipa	Quality Foods Centers	1997	203	1,200
Albertson's	Lucky (American Stores[1])	1998	448	8,295
Midwestern region			**238**	**7,231**
Giant Eagle	Riser Foods	1997	56	4,000[2]
Lund's	Byerly's	1997	11	65
Albertson's	Jewel/Osco (American Stores[1])	1998	171	3,166
Northeastern region			**698**	**15,388**
Ahold	Stop & Shop	1996	189	4,400
Ahold	Giant Food, Inc.	1998	176	4,200
Albertson's	Acme (American Stores[1])	1998	183	3,388
Food Lion	Hannaford	1999	150	3,400
Southeastern region			**244**	**2,415**
Food Lion	Kash & Karry (Florida)	1997	100	1,000
Jitney Jungle	Delchamps	1997	118	1,300
Kohlberg & Co.	Schwegmann's	1997	26	115
Inter-regional			**1,028**	**19,800**
Safeway	Dominicks	1998	112	2,300
Kroger	Yucaipa/Fred Meyer	1999	800	15,000
Safeway	Randalls	1999	116	2,500

1. Sales of American Stores (Lucky, Jewel-Osco, and Acme) totaled $19.9 billion in 1998, including sales of 773 pharmacy/drugstores. 2. Sales include wholesale sales to 586 independent grocery retailers.
Sources: Company annual reports, *Wall Street Journal*, *Supermarket News*, and *Food Institute Weekly Digest*.

Economic Research Service, USDA

consumers. To address time-pressured shoppers' need for convenience, grocery retailers introduced salad bars and prepared foods. Although many supermarkets contained a service meat counter in the 1980's offering sliced-to-order items, there were few prepared hot or heat-and-serve offerings. By 1997, fully 83.6 percent of supermarkets sold prepared foods, such as sandwiches, pizza, and pasta dishes, accounting for 4 percent of store sales, on average.

Retailers have added new products (food and nonfood) as well as services, and have built larger stores in order to offer consumers "one-stop shopping" convenience. At the same time, though, they have incurred increased procurement, labor, and capital investment costs.

Retailers Seek Lower Costs

Large grocery retailers, strongly motivated to offset the higher costs of serving consumers, are seeking efficiency gains and lower capital investment costs. Many of them, counting on the economies of size that come with consolidation, have apparently opted to pursue mergers and acquisitions.

Consolidating food retailers often cite the potential for lower costs as an incentive for becoming larger. These retailers believe they can decrease costs through supply-chain management practices—coordinated activities that generate operating, procurement, marketing, and distribution efficiencies. Expected efficiency gains and lower investment requirements will allow them to maintain profitability while keeping prices competitive with mass-merchandisers, warehouse club stores, and other emerging and potential rivals.

To reduce operating costs, large retailers are centralizing management and control at corporate headquarters. New information technologies such as companywide satellite and Internet communication systems, and store checkout scanner data, allow for centralization of many management activities that previously were the responsibility of store managers. The availability of timely and detailed information at headquarters also allows for effective control of operations over relatively large geographic areas.

Consolidation of retail grocers also allows for greater efficiencies in purchasing retail products from suppliers. When retailers can buy higher volume from individual suppliers and distributors, they can negotiate lower wholesale prices and in turn lower per-unit prices at the retail level while maintaining store margins. In return, retailers are able to offer exclusive procurement agreements, with potential benefits to suppliers and distributors such as partnering, long-term agreements, and other strategic alliances. Retailers also gain a more reliable source of supply and, over time, can work to develop a higher quality and more uniform product, especially for perishable products such as fresh meat and produce.

Merging retailers also credit exclusive partnerships with suppliers for reducing costs associated with the marketing and selling functions of retail goods. Suppliers and distributors, as a condition of the partnership, provide additional marketing services that formerly were the responsibility of retailers. These include in-store promotion and point-of-purchase materials, sales-event planning and advertising, and special packaging. Some retailers then share checkout scanner sales data with suppliers and distributors in order to better evaluate promotions, seasonal sales differences, price responses, and other factors of consumer demand.

Consolidating retailers can also enjoy cost savings by streamlining product distribution functions. Large retailers typically are self-distributing, i.e., they perform wholesaling activities such as purchasing goods from suppliers, arranging for shipment to distribution warehouses, and replenishing store-level inventory. These large retailers can operate fewer distribution centers and use remaining warehouses more intensively. To reduce costs, large retailers use supply-chain management practices such as:

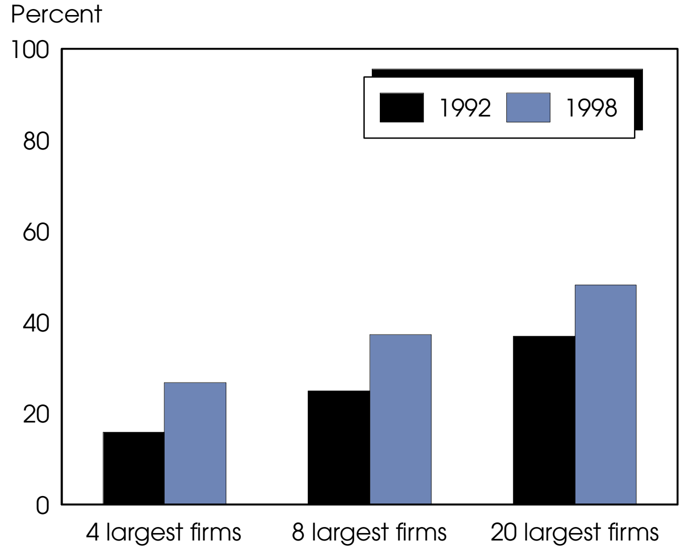
- continuous inventory replenishment, with more frequent deliveries from suppliers reducing retailers' storage and inventory costs;
- use of cross-docking facilities (where suppliers' single-load truck shipments transfer directly to mixed-load trucks for shipment to stores, bypassing warehousing;
- direct store delivery to supermarkets by suppliers; and
- selective use of specialized wholesalers.

Another factor in the growth of mergers and acquisitions is the higher capital investment costs of building new stores and establishing a customer base, compared with purchasing existing ones through merger and acquisition. Today's larger supermarkets and supercenters call for much higher sales volume in order to achieve profitability. As long as 2 years may be required to develop sales volume sufficient to achieve profitability. But most existing stores have already reached minimum sales requirements for profitability, while unprofitable stores can be sold.

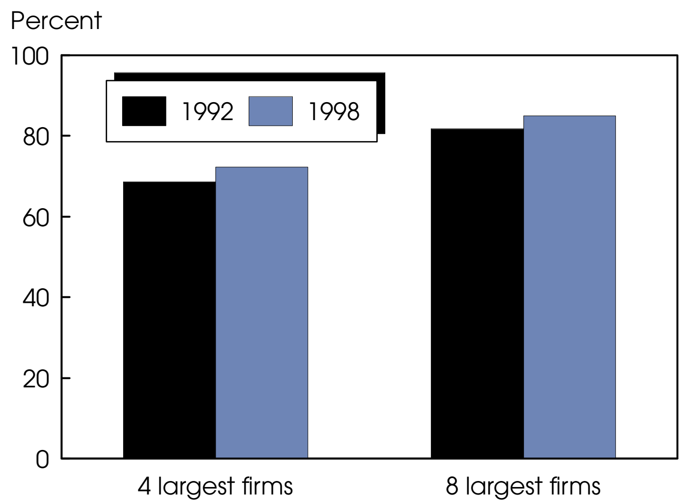
Market Share of Key Players Increases

A sharp increase in the number of mergers and acquisitions, particularly since 1996, brings increasing national concentration levels, as measured by the share of grocery store sales accounted for by the largest 4, 8, and 20 retailers ranked nationally. Between 1992 and 1998 the share of sales for the four largest retailers rose from 15.9 percent in 1992, to 28.8 percent in 1998. Similarly, the eight-largest retailers' share increased to 39.4 percent in 1998, up from 24.9 percent in 1992. The largest 20 retailers' sales share reached 48.2 percent of total grocery store sales in 1998, compared with 37 percent in 1992.

While Largest Food Retailers Have Seen Strong Growth in Nationwide Market Share. . .



. . .Concentration in Local Markets Has Increased Only Slightly



Simple average of shares in largest 100 Metropolitan Statistical Areas—geographic areas that contain a population center of 50,000 or more and typically consist of a city and its adjacent counties.

Economic Research Service, USDA

Internal growth may also have contributed to increased national concentration, most likely among the 9th- through 20th-ranked retailers that have increased sales by opening new stores. Despite the gains in national market shares, to date, none of the largest 20 retailers operates in all regions of the U.S.

The degree of concentration in food retailing is low when compared with other categories of retailers and manufacturers. A number of food processing industries are far more concentrated at the national level, with the leading four firms accounting for higher shares of sales—e.g., 85 percent of breakfast cereal sales, 75 percent of chocolate and cocoa product sales, 66 percent of roasted coffee product sales, and 56 percent of cookie and cracker product sales in 1992. The leading food processors sell in national markets, while retailers serve customers in local markets, making national market shares less relevant. Nevertheless, year-to-year changes in national concentration provide a measure of the net effect of internal growth, firm consolidation, and divestitures among the largest food retailers over time.

Local Markets Matter to Consumers

While many recent consolidations shared one or more market regions, food retailers actually compete directly within smaller geographic markets, such as a city or town. As a result, the effect of consolidation on consumers is related primarily to increases in local market concentration—the combined sales of the largest firms expressed as a share of the total local market sales. With a merger of two large supermarket firms operating in the same local market, local sales concentrate, creating concerns about the potential for higher prices and reduced variety. Empirical evidence relating increased concentration to rising grocery prices is inconsistent. But in the extreme, a single retailer in a local market would constitute a monopoly and could set prices above a competitive norm.

To study the effects of recent consolidation on consumers, ERS analyzed changes in local market concentration for the 100 largest cities, defined by the Census Bureau as Metropolitan Statistical Areas (MSA's). An MSA geographic area contains a population center of 50,000 or more and typically consists of a city and its adjacent counties. These MSA's accounted for 166.7 million people, almost 62 percent of the U.S. population in 1998. Individual market-share data in each MSA were used to calculate the share of total supermarket sales accounted for by the combined sales of the largest four and eight food retailers. The study compared MSA sales concentration in 1992 and in 1998 to capture changes in market concentration during widespread mergers and acquisitions among large food retailers. Both four- and eight-firm concentration shares were calculated.

Four-firm concentration in 1992 ranged from 29.8 percent in Allentown-Bethlehem-Easton, Pennsylvania, to 92.5 percent in West Palm Beach-Boca Raton, Florida. Similarly, in 1998, least and most concentrated MSA's were New York City (30.6 percent) and West Palm Beach-Boca Raton (95 percent). Overall, the 100 largest cities had an average four-firm concentration of 68.6 percent in 1992, while in 1998, the four-firm share had increased to an average 72.3 percent of MSA supermarket sales. In comparison, the eight largest supermarket retailers held a share of sales averaging 80.8 percent in 1992, increasing to 85 percent in 1998.

These results indicate only modest increases in local market concentration compared with the sharp rise in national concentration—3.7 percentage points in the average four-firm MSA concentration over the 6-year period, and 4.2 percentage points among the eight-firm share average between 1992 and 1998. Most recent mergers have had little impact on local consumer markets because there were relatively few instances of overlapping markets among the merging or acquired firms.

Among safeguards protecting consumers is public policy designed to preserve competition. Following merger guidelines and other criteria, antitrust agencies (the Federal Trade Commission or the Department of Justice) have required divestiture of stores in overlapping markets that would otherwise have the effect of raising market concentration or substantially eroding competition.

The FTC consent agreement in the Albertson's-American Stores merger required the divestiture of 104 Albertson's supermarkets and 40 American Stores supermarkets operating in 57 cities and towns located in California, Nevada, and New Mexico. Sale of these stores provided opportunities for smaller competitors to purchase the divested supermarkets and compete in those markets.

Such extensive government intervention is not always needed, however. The merger of Kroger and Yucaipa/Fred Meyer, for example, resulted in very few divestitures, because of the minimal number of overlapping regions and local markets involved.

Product Suppliers Adjust to Consolidation

Large, self-distributing retailers accounted for about half of the $458 billion in retail sales by food stores and mass-merchandiser supercenters in 1998. These large firms operate their own warehouses, trucking fleets, and buying offices, enabling them to negotiate directly with grocery suppliers. Consolidation among these retailers, as they become fewer but make higher-volume purchases, has concentrated direct procurement of food and nonfood products.

As more retailers adopt supply-chain management practices for product procurement and distribution, concerns arise that competition may diminish substantially. Grocery product suppliers may face fewer but larger volume buyers of their products and commodities as consolidated food retailers reduce the number of buying offices and combine orders in order to obtain price concessions and other procurement efficiencies. Grocery suppliers have cited new marketing and trade promotion practices, such as slotting allowances (lump sum payments to a retailer as a precondition for sale) and performance requirements and fees such as charges for special advertising and promotions, as evidence that suppliers may be disadvantaged in bargaining with large retailers. Suppliers of branded products may justify such fees and allowances as necessary to compete with similar brands for retailers' valuable shelf space.

Grocery suppliers will be challenged to meet the needs of retailers that adopt supply-chain management practices. Many smaller grocery suppliers may conclude that by forming joint ventures and cooperatives of their own, they are better able to meet the procurement and marketing demands of large retailers. Other small supplier firms are seeking niche markets for a limited range of product offerings, such as specialty fruits and vegetables, or organically grown products, in order to meet the procurement needs of all sizes of retailers.

Through growth of the Internet and proliferation of online services, smaller suppliers are now able to locate buyers through a growing number of virtual marketplaces. These online marketplaces offer access to buyers that previously were difficult and costly to identify. Virtual sites such as Buyproduce.com are open to all buyers and sellers, while producer groups such as Farmconnect.com, a Minnesota-based farm cooperative, offer value-added commodities to all types of buyers. In the future, Internet-based marketplaces will provide more alternatives to grocery products suppliers that are too small or otherwise unable to meet the requirements of large retail buyers. AO

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