U.S. Fresh Fruit and Vegetable Marketing: Emerging Trade Practices, Trends, and Issues. By Linda Calvin and Roberta Cook (coordinators); Mark Denbaly, Carolyn Dimitri, Lewrene Glaser, Charles Handy, Mark Jekanowski, Phil Kaufman, Barry Krissoff, Gary Thompson, and Suzanne Thornsbury. Market and Trade Economics Division, Economic Research Service, U.S. Department of Agriculture. Agricultural Economic Report No. 795.

Abstract

In the past year, trade practices between fresh produce shippers and food retailers gained national attention. Shippers are concerned that recent retail consolidation has led to market power and the growing incidence of fees and services. Retailers argue that these new trade practices reflect their costs of doing business and the demands of consumers. Trade practices include fees such as volume discounts and slotting fees, as well as services like automatic inventory replenishment, special packaging, and requirements for third-party food safety certification. Trade practices also refer to the overall structure of a transaction—for example, long-term relationships or contracts versus daily sales with no continuing commitment. This study compares trade practices in 1999 with those prevalent in 1994, placing them in the broader context of the evolving shipper/retailer relationship. Most shippers and retailers reported that the incidence and magnitude of fees and services associated with transactions has increased over the last 5 years. Fees paid to retailers are usually around 1-2 percent of sales for most of the commodities we examined, but 1-8 percent for bagged salads. Information on the incidence and magnitude of these new practices is scarce. To augment information that is publicly available, we interviewed a limited number of shippers, retailers, and wholesalers about their firms and trade practices. We received a high level of voluntary cooperation from the interviewed firms.

Keywords: Produce, fresh fruit and vegetables, fresh-cut produce, trade practices, fees and services, slotting fees, retail consolidation, produce shipper consolidation.

Note: Use of brand or firm names in this publication does not imply endorsement by the U.S. Department of Agriculture.

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Preface

This is the second in a series of three reports assessing the changing nature of the produce shipper/retailer relationship and the implications for competitive behavior. Such an assessment requires an objective understanding of the increasingly complex relationships among buyers and sellers along the marketing chain. The Economic Research Service (ERS) is working with industry experts to undertake descriptive and analytical research studies. This project has three major objectives:

- ❖ Develop a comprehensive overview of the produce industry from shipper to retailer, including consumption and retail sales trends, markets and marketing channels, and the changing structure of produce buyers.
- ❖ Identify and characterize the types of trade practices used in the produce industry, including fees and services provided by shippers, contracts, and other marketing strategies.
- ❖ Empirically analyze shipper/retailer price margin behavior to investigate whether retail market power can be detected.

The first objective was addressed in *Understanding the Dynamics of Produce Markets: Consumption and Consolidation Grow,* published by ERS in August 2000. This report addresses the second objective. The third objective will be addressed in a forthcoming ERS report. Taken together, these reports will inform industry participants, researchers, and policymakers about the forces affecting competition and change in the produce industry.

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Executive Summary

In the past year, trade practices between fresh produce shippers and food retailers gained national attention. The Federal Trade Commission and the U.S. Senate Committee on Small Business conducted hearings in which industry leaders, government officials, and academics offered their perspectives on how both the recent wave of supermarket mergers and the growth of new trade practices have affected various industries, including the produce industry (U.S. Senate, 1999; U.S. Senate, 2000; Federal Trade Commission, 2000). Shippers are concerned that recent retail consolidation has led to market power and the growing incidence of fees and services. Retailers argue that these new trade practices reflect their costs of doing business and the demands of consumers.

Trade practices is a broad term that refers to the way shippers and retailers do business, including fees such as volume discounts and slotting fees, as well as services like automatic inventory replenishment, special packaging, and requirements for third-party food safety certification. Trade practices also refer to the overall structure of a transaction—for example, long-term relationships or contracts versus daily sales with no continuing commitment.

This study compares trade practices in 1999 with those prevalent in 1994, placing them in the broader context of the evolving shipper/retailer relationship. Information on the incidence and magnitude of these new practices and how they affect shippers, retailers, and consumers is limited. Public information about produce shippers and the nature of their transactions with retailers is scarce as well, in part because the data are proprietary. To augment information that is publicly available, we interviewed a limited number of produce shippers, retailers, and wholesalers about their firms and trade practices. We received a high level of voluntary cooperation from the interviewed firms.

The Interviews

For shipper interviews, we generally spoke with owners and/or senior sales and produce managers, and they often consulted their financial and accounting departments to provide us information. We did not directly review sales accounts from firms' records to confirm the information provided. The interviews focused on seven products: California grapes, oranges, and tomatoes; Florida grapefruit and tomatoes; and California/Arizona lettuce and bagged salads. We interviewed no more than 9 shippers per commodity in any geographical region, 57 in all. For some commodities, the supply side is rather consolidated, meaning that the seemingly small sample accounts for a relatively large share of total sales.

To complement the shipper interviews and provide a stronger view of the shipper/retailer relationship, we interviewed a limited number of retailers and wholesalers for their perspective. We selected firms across regions and included a mix of retailer and wholesaler types and sizes. The sample included eight national chains (three headquarter and five division offices), six midsize regional chains, and three large general-line wholesalers. The retail interviews asked about the same seven products as the shipper interviews.

Since our interviews were limited in number, our findings should be interpreted with caution. In particular, the quantitative results presented should be viewed as indicative of industry practices rather than a precise accounting. Nevertheless, the information from these interviews is an important first step in understanding the recent changes in produce marketing.

Study Highlights

- *Retail Concentration.* The 4 largest retailers' share of grocery store sales rose from 17 percent in 1987 to 27 percent in 1999, and the 20 largest from 37 to 52 percent. Shippers are concerned about the accelerated pace of consolidation in part because market structure is still very fragmented at the shipper level for many commodities, implying low countervailing power relative to the fewer, larger buyers.
- *Shipper Concentration.* While shipper consolidation is occurring, it varies significantly across commodities. For example, in 1999 there were 149 California grape shippers with none estimated to account for over 6 percent of total industry sales. At the other extreme, there were only 25 California tomato shippers. While there were 54 bagged salad firms selling to retailers, the top 2 firms accounted for 76 percent of total fresh-cut salad sales in supermarkets. Hence, for a few fresh produce items, concentration of sales at the shipper level has surpassed that of retailers, even though the sales of these firms may still be small relative to those of the large retail chains.
- *Many Factors Affect the Shipper/Retailer Relationship.* Retail consolidation is not the only factor affecting the shipper/retailer relationship. Changes in consumer preferences for variety, convenience, and food safety; changes in technology; and changes in shipper consolidation have all played a part in the evolution of the two industries and their interactions.
- *Number of Buyers.* Despite perceptions to the contrary, when shippers reviewed their records, many found relatively small changes in the number of regular customers when considering ***all buyer types***. While some shippers reported a decrease in the total number of customers, roughly as many reported an increase. Most shippers believed that the number of ***retail customers*** had declined, and the majority viewed this as harmful. Other shippers were selling to fewer but larger retail accounts and felt this reduced their transaction costs. With declining retail customers, most shippers thought they had less negotiating power and were more fearful of losing accounts if they did not comply with buyer requests. Some shippers were replacing retail accounts with other types of buyers, sometimes due to declining competitiveness in serving the needs of large retailers. In any case, many shippers are adjusting their marketing strategies to sell to other types of buyers.
- *Marketing Channels.* The share of sales to conventional retailers was either stable or declining for all products. Regardless of how marketing channel shares changed over the 1994-99 period, direct grocery retail sales remain the most important marketing channel for sales of all the products studied except California and Florida tomatoes. An important factor affecting the share of produce sold to grocery retailers is the growth in competition from mass merchandisers. The share of shipper sales to mass merchandisers, although starting from a small base, was up across all commodities with the largest gains in grapes, oranges, and grapefruit. The competitive effects of mass merchandisers on conventional retailers are evident in that the share of direct sales to conventional retailers was stable or declining in the face of the growth in direct sales to mass merchandisers, consistent with broad food industry trends. Combining mass merchandisers

(also retailers) with conventional grocery retailers, the “retail” share of sales increased for every crop considered except California and Florida tomatoes. This broader definition captures the evolving structure of the U.S. food marketplace in which a new type of retailer is playing a greater relative role.

- *Retail Buying - Corporate, Division, and Field Buyers.* While consolidating retailers often cite the potential for lowering procurement, marketing, and distribution costs, many recently merged chains are still in the process of integrating their buying operations. Indeed, over the last 5 years, retailers reported that the number of their buyers remained fairly constant at the corporate and division levels, although 18 percent reported a decline in field buyers. As retailers fully integrate their acquired chains and implement new procurement models designed to streamline the supply chain, the buying practices of retailers may become more centralized than they have to date.
- *Importance of Largest Buyers and Suppliers.* While the total number of buyers of all types may not have changed much for most shippers over the last 5 years, the importance of the largest buyers has increased, but only slightly. The share of the top four buyers of total shipper sales ranges from 22 to 45 percent of sales, depending on the product. The largest increase in this share was for Florida tomato shippers, from 34 percent in 1994 to 45 percent in 1999. For their part, retail buyers report more concentrated purchases, with their top four suppliers providing from 85 to 97 percent of total purchases, depending on the product.
- *Daily and Advance Sales.* Traditionally, the fresh produce industry has concentrated on daily sales. For commodities (grapes, oranges, grapefruit, and tomatoes), daily sales remain the most important sales mechanism across all types of buyers, but the share declined from 72 percent in 1994 to 58 percent in 1999. The use of advance pricing arrangements for promotions increased from 19 to 24 percent over the same time period and it appears that the number of weeks in advance for which prices are fixed has grown as well.
- *Use of Contracts.* The use of contracts is also becoming more common. The point of distinction (relative to daily sales) is ongoing sales and marketing agreements with buyers versus single shipments. In 1999, short-term contracts accounted for 11 percent of total commodity sales (grapes, oranges, grapefruit, and tomatoes), and long-term (annual or multiyear) contracts 7 percent. Lettuce sales mechanisms in 1999 were similar to other commodities except all contracts were long term. Bagged salad shippers indicated that annual or multiyear contracts are the standard for retail sales.
- *Fees and Services.* Most shippers and retailers reported that the incidence and magnitude of fees and services associated with transactions had increased over the last 5 years; a few tomato shippers reported no change. Data were collected from commodity shippers on actual fees paid to the top five retailer and mass merchandiser accounts. They were usually around 1-2 percent of sales for most commodities. Bagged salad firms reported a range of fees paid of 1-8 percent for all retail accounts. Fees paid to all retailer and mass merchandiser accounts averaged $5,200 and $8,700 per million dollars of sales, respectively, for the interviewed grape and orange shippers, compared with $10,100 for the grapefruit shippers and only $1,300 for California tomato shippers. Fees can make the difference between profit and loss, especially for commodity shippers who act as price takers and are therefore less able to pass costs along to customers. Services per million dollars of sales were less than fees for all the commodity samples, averaging from $1,200 for grapes to $4,400 for grapefruit. However,

many firms did not keep close track of the cost of fees and, in particular, services.

- *Types of Fees.* Overall, 48 percent of the types of fees requested were new in the last 5 years. The most frequently paid type of fee is the volume discount, a trade practice that has been used for years, although shippers agree that the incidence and magnitude of this fee has increased. Shippers generally viewed this fee as having a negative or neutral impact on their business. Still, volume incentives have the potential to promote a more stable relationship between suppliers and retailers; as the retailer buys more units from the supplier, costs per unit decline, providing an incentive for the retailer to buy larger quantities (over the season) from a particular supplier. Shippers may also gain efficiencies in marketing by increasing the size of accounts.

- *Slotting Fees and Fresh-Cut Produce.* While slotting fees (defined, in this case, as an upfront fee to gain retail shelf space for a new or existing product) have long been used in the grocery store outside of fresh produce, they recently entered the fresh produce department with the advent of fresh-cut fruits and vegetables. Slotting fees are now common for fresh-cut produce and may be either requested by retailers or offered by shippers. Most bagged salad shippers reported that it was shippers, not retailers, who first introduced slotting fees to this industry in an attempt to buy market share from their competition, and that the fees began prior to the last wave of retail consolidation. None of the bagged salad shippers revealed the exact size of the slotting fees requested or paid by their firm or for individual accounts, but several talked about the general use of slotting fees in the bagged salad industry. Slotting fees were reported to range from $10,000-$20,000 for small retail accounts to $500,000 for a division of a multiregional chain, and up to $2 million to acquire the entire business of a large multiregional chain.

- *Slotting Fees and Commodities.* In contrast to fresh-cut shippers, none of the commodity shippers reported paying slotting fees as defined above. However, a few were asked to pay, and some lost accounts when they failed to comply. Shippers do not always distinguish between slotting fees and other fees such as a fixed, upfront promotional allowance.

- *Types of Services.* Service requests are also increasing, with 77 percent of requests reported as new in the last 5 years. Shippers tended to believe they receive more benefits from providing services than from paying fees. According to shippers, the most common service requested is third-party food safety certification, with one-third viewing it as harmful and the remainder feeling that the impact of providing this service is beneficial or neutral.

- *Adverse Effect on Smaller Shippers.* Fees and services can more adversely affect smaller shippers if they are fixed and equal in cost across all shippers. While fees are generally per-unit costs, services are mainly fixed costs and so may be more difficult for small shippers to implement since they are spreading the costs across fewer units. If requests for fixed fees and services grow, smaller shippers may need to seek alternative buyer types. Preliminary canvassing of shippers for this study indicated that smaller shippers were already selling very little to retail buyers. Aside from the issue of fees and services, small shippers are generally unlikely to provide adequate volume to supply large retailer needs.

Public Policy Issues

Part of the interest in this study stems from concern of produce shippers, growers, and their associations regarding how pervasive fees and services have become and whether the requests for fees and services represent market power on the part of retailers. The Federal Trade Commission (FTC) and the Department of Justice are the Federal agencies that determine whether a pricing strategy violates antitrust legislation, or, in other words, is anticompetitive. FTC decisions are based on both legal and economic precepts. USDA's Economic Research Service contributes to the policy debate through analyses—such as this study—that explore produce marketing in detail.

Another important policy issue is the effect of changing trade practices on USDA's produce price reporting activities. USDA's Agricultural Marketing Service (AMS) collects free-on-board (f.o.b.) shipping-point prices based on daily sales for major fresh fruits and vegetables, and daily spot prices in terminal wholesale markets for nearly 300 products. As shippers reduce their reliance on daily sales and move more to contracts, f.o.b. shipping-point prices will still represent daily prices but they may gradually become less representative of prices for commodities being sold under other sales mechanisms. However, contracts may rely on formula pricing derived from Market News prices. Many transactions are more complex than ever before, with price just one of several important parameters describing the sale. Transactions may specify quality characteristics; payment of off-invoice fees such as promotional fees, rebates, or other discounts; volume commitments; or the provision of special services. The proprietary nature of many transactions makes the price discovery process more complex. This poses new challenges for data collection but AMS' Market News Branch reviews its strategies on an ongoing basis to adapt to new market conditions. Also, as shippers and buyers use more direct sales, bypassing wholesale markets, spot prices there become less robust and offer less information to industry players concerned about understanding price trends. It is important to note, however, that wholesale market prices should continue to play a particularly important role in price discovery for many minor products, which do not generally have shipping-point price reports.