

Factors Affecting the Shipper/Retailer Relationship

Many factors underlie the recent changes in the shipper/retailer relationship, including changes in consumer demand, technological innovation, and the consolidation of the retail industry itself. Americans have become more health-conscious, and are consuming 49 pounds more fresh fruits and vegetables per capita in 1999 than in 1986. As consumption has increased, so has the demand for variety and convenience. The typical grocery store carried 345 produce items in 1998, compared with 173 in 1987 (Litwak, 1988 and 1998).

These new items are both exotic imports as well as variations on standard products. For example, in addition to traditional mature green and vine-ripe tomatoes, product differentiation has generated a wide array of new tomato products: extended-shelf-life, grape, yellow, and red baby pear tomatoes, as well as cluster, greenhouse, organic, and heirloom varieties. Variety is also evident in the year-round availability of items once thought seasonal, with U.S. consumers willing to pay the higher price for imported out-of-season fresh products. Given the product diversity and seasonality of production of some crops (grapes and tomatoes, for example), retailers have increasingly sought to reduce costs by dealing with suppliers that can provide broader product lines year-round or over extended seasons. This trend pressures U.S. shippers to coordinate with shippers in other countries and to diversify their product lines to meet retailers' more complicated needs. However, providing a broader product line on a year-round basis can be risky and costly, given the high capital requirements involved in the production and distribution of many fresh produce items. Large firms may more easily find funds to support these activities, which favors consolidation and greater vertical and horizontal coordination in the produce shipping industry (Wilson et al., 1997).

Consumer habits are also affecting shippers. Many shippers find their share of sales to foodservice buyers increasing as consumers eat more food away from home. In 1999, 48 percent of total spending on food went to the foodservice sector, up from 44 percent in 1992 and 40 percent in 1982 (Kaufman et al., 2000a). This change in consumer habits also affects retailers who are faced with a declining share of consumer food spending. Many are introducing more ready-to-eat meals, commonly referred to as retail Home-Meal-Replacement or Meal Solutions.

As Americans spend less time preparing the meals they eat at home, the convenience of fresh-cut produce has become more important. Bagged salads (washed, cut, and ready-to-eat salads) are now a major sector of the produce industry. New developments in packaging technologies have spurred the growth of a wide array of fresh-cut products, still primarily on the vegetable rather than the fruit side of the industry. Marketing fresh-cut produce differs from bulk commodities in that they are usually either branded or private-label products, which need dedicated shelf space year round. In 1997, 19 percent of retail produce sales were branded products, compared with only 7 percent in 1987 (Kaufman et al., 2000b).

Growth of the fresh-cut industry may also have structural impacts. Bagged salads require substantial capital investments in plants and machinery, in excess of \$20 million for a processing plant. This creates a significant barrier to entry, particularly when the fixed assets have relatively limited use outside of processing salad ingredients. Research and development to produce sophisticated films to manage product transpiration/respiration rates and extend shelf life is also costly.

As a result of the high costs of entry and other factors, the number of firms in the bagged salad industry is relatively small. For 1999, Information Resources, Inc. (IRI) scanner data show that 54 firms sold to mainstream supermarkets (these firms may also sell to other types of buyers as well) and that the two largest firms accounted for 76 percent of fresh-cut salad sales. However, there are still other fresh-cut processors serving foodservice and other local and regional processors producing more perishable fresh-cut produce—such as fruit and limited-shelf-life vegetables like chopped tomatoes and onions—for nearby markets. More stringent food safety standards may contribute to further consolidation in the fresh-cut processing industry.

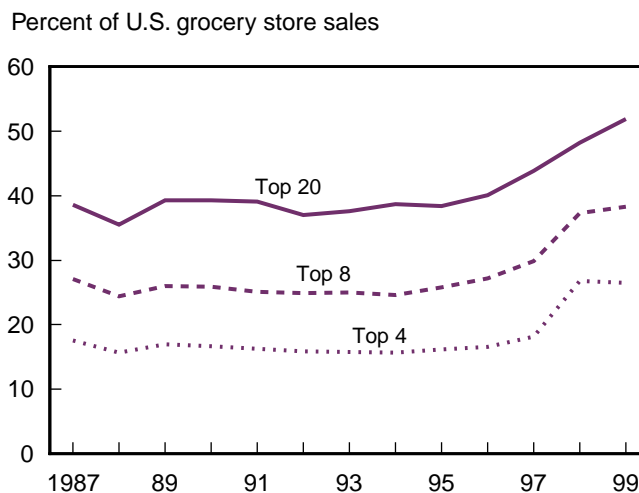
Increased coordination between shipper and buyer becomes critical as shippers develop more specialized or differentiated products for particular buyers. For example, a retailer may want products tested for food safety by specific companies, a particular brand of bagged salad, or an unusual domestic or imported product. The growing use of shipper/retailer contracts is one way to achieve vertical coordination. Use of contracts can also have structural impacts, as shippers often need to have a large supply to guarantee volume commitments (Carman et al., 1997).

New technology is transforming the shipper/retailer relationship as well. Information technologies have dramatically changed the amount and timeliness of information available. With the advent of standardized price look-up (PLU) codes on variable-weight products, retail sales data are now available, allowing for the implementation of category management programs in the produce department. With more accurate tracking of sales and profit margins, shippers and retailers can work together to improve category profitability by designing effective sales, product mix, and pricing strategies, potentially benefiting preferred suppliers as well as the retailer. Investing in the human resources and technology necessary to analyze category information, however, may be difficult for smaller shippers to finance. As a result, grower/shipper mandated marketing programs, such as the California Tomato Commission, are developing category management programs with selected retailers, enabling shippers of all sizes to share in the benefits.

Improvements in transportation and technologies that prolong the life of fresh produce have also boosted trade (Carman et al., 1997). Globalization of the produce market can introduce both new competition and new opportunities. While freer international trade has facilitated shippers' efforts to provide a year-round supply to their buyers, sudden influxes of imports during competing seasons can force adjustment on U.S. growers and shippers. For example, the recent growth of clementine imports during the winter has placed new competitive pressure on California orange growers and shippers. Still, in a consumer-driven system, imports will likely continue to grow in response to consumer demand. To be competitive, more shippers are expected to position themselves to participate in this growing trade.

Retail consolidation at the national level has altered the shipper/retailer relationship. A recent wave of food retail consolidation has seen the sales shares of the largest 4, 8, and 20 U.S. retailers' rise sharply. The top 20 retailers consist exclusively of retail chains, with the number of grocery stores per chain ranging from 57 to over 2,200. In 1999, the 4 largest food retailers' share of grocery store sales was 27 percent, up from 18 percent in 1987; the 8 largest retailers' share was 38 percent, up from 27 percent; and the 20 largest retailers' share was 52 percent, up from 39 percent (fig. 1). While food retailers have been consolidating, so have other produce buyers such as wholesalers that sell to retail buyers.

Figure 1
Grocery sales of the largest four, eight, and twenty food retailers, 1987-99



Sources: Census of Retail Trade, Census Bureau, 1987 and 1992; and company annual reports.

Grocery-oriented wholesalers undertook 32 mergers and acquisitions in 1999 and a cumulative total of 105 since 1997. Foodservice wholesalers completed 31 mergers and acquisitions in 1999. Still, foodservice wholesalers remain relatively fragmented. In 1998, the 4 largest foodservice wholesalers accounted for 21 percent of the \$147 billion in total foodservice wholesale industry sales, followed by the top 8 and 20 firms with 25- and 27-percent shares (Tanyeri, 1999). Ongoing consolidation in the general-line, produce (specialized), and foodservice wholesaling industries will continue to contribute to a more consolidated marketplace, even though consolidation at the wholesale level still lags behind retail.

Retail consolidation has influenced the way firms deal with produce shippers. Retailers often cite the potential for lowering procurement, marketing, and distribution costs as motivating mergers and acquisitions. By purchasing more volume directly from larger shippers, retailers hope to gain greater efficiency in procurement by eliminating intermediaries and lowering the per-unit cost of goods. Large retailers also desire large volumes of consistent product to provide uniformity across all their stores, which may be more easily supplied by larger shippers. In return for consistent supply, retailers are able to offer shippers preferential procurement agreements such as partnering, long-term agreements, and other strategic alliances that can be mutually beneficial. Large retail-

ers can also achieve marketing efficiencies, such as lower costs for advertising.

Consolidating retailers have also cited potential cost savings through streamlining of product distribution functions. Large retailers typically are self-distributing; they perform wholesaling activities such as purchasing goods from suppliers, arranging for shipment to distribution warehouses, and replenishing store-level inventory. Supply-chain management practices such as continuous inventory replenishment are becoming more common. Under this system, shippers have access to retail sales data and are responsible for providing the correct amount of produce to each distribution center served, on a just-in-time basis, potentially reducing the size and cost of retail distribution centers. It also allows retailers to streamline and downsize their produce buying offices. However, to date, mainly mass merchandisers rather than conventional grocery retail chains have implemented automatic inventory replenishment systems in fresh produce. The future impact of consolidation on shippers depends in large part on the types of procurement models eventually adopted

by the consolidating firms and whether they turn to more closely coordinated supply chain models.

In general, shippers have also been consolidating, although there is considerable variation among different sectors. For example, of 149 California fresh grape shippers, none are estimated to account for over 6 percent of total industry sales. In contrast, there were only 25 California tomato shippers in 1999 and 23 in 2000. Although there were 54 bagged salad firms in 1999 selling to mainstream supermarkets, the top two accounted for 76 percent of total fresh-cut salad sales. Hence, for a few fresh produce items, consolidation at the shipper level has surpassed retail consolidation, even though the sales of these firms may still be small relative to those of the large retail chains. Shipper consolidation is motivated by many of the industry trends discussed above. Larger firms are more able to provide the services requested by consolidating retailers, and they may also develop some countervailing power in their relationships with retailers. More shipper consolidation is expected in the future (Eldredge, 2000).