

## Conclusions

Trade practices used in shipper/retailer transactions is a topic that has recently come to the attention of policy-makers. This report provides a description and analysis of the trade practices currently used in shipper/retailer transactions and the economic forces behind recent changes in the produce industry. The findings in this study are based on a limited number of shipper, retailer, and wholesaler interviews and publicly available information; as a result, they must be interpreted as indicative of industry trends rather than authoritative results. This research is a first step; while we answer many questions about trade practices, many remain and will undoubtedly be the focus of future research.

The study examined the evolution of marketing channels used by shippers over the 1994-99 period. Conventional retail buyers remain the primary marketing channel for domestic sales of all the products examined except for California and Florida tomatoes (tomatoes are typically sold to repackers servicing final buyers). However, the *share* of total sales to conventional retail buyers did not increase for any product in our sample, despite the emergence of larger retail buyers. For grapes, oranges, and California tomatoes, the *absolute* dollar volume of sales to this channel did increase, but this was due to growth in the total sales volumes for the sampled firms rather than an increase in the retail share of total sales.

The stable or declining share of sales to conventional retailers was likely due in part to an increase in sales to mass merchandisers, a new segment that grew rapidly during the 1990's. If mass merchandisers are included in the retail category, the share to retail increased for all products except tomatoes. Hence, for most commodities, even where there was a declining relative share of sales to retailers, this was more than offset by the growth in relative importance of mass merchandisers.

Some of the changes observed in marketing channels are probably due to retail consolidation. For example, smaller shippers may not be able to match the large buying requirements of consolidated retailers. However, some of the change may be due to other economic factors such as growth in foodservice demand.

Given recent retail consolidation, we expected that shippers would have fewer total buyers and possibly encounter less competitive markets. However, when asked about the number of total accounts for all buyer

types in 1999 compared with 1994, about equal numbers of shippers reported increases as decreases, with a few reporting no change. Factors affecting the number of total buyers, independent of changes in retail consolidation, include changes in volume of sales or product line, acquisition of other shipping firms, and changes in business focus. In addition, retailers reported that over the same period, their total number of produce buyers had declined only slightly. Indeed, 60 percent of retailers said that when they consolidated, the number of buyers remained the same at the field and division levels, while 18 percent reported reducing the number of field-level buyers. As the buying structure of the now larger retailers continues to evolve, buying may become more centralized than it has to date, implying fewer accounts.

When asked specifically about their number of retail accounts, most shippers perceived a decline due to retail consolidation, and that this had an adverse effect on their business. The impact of consolidation on individual shippers was highly correlated with their relationship with the merging chains prior to consolidation. If a shipper supplied the acquiring but not the acquired chain, the shipper might gain by additional sales to the now larger account. Conversely, if a shipper supplied the acquired chain, the account might be lost.

For commodity shippers in 1999, their four largest customers comprised from 22 to 45 percent of sales to all types of buyers. Such dependence may compromise shippers' power in negotiating with buyers over prices and requests for fees and services. For their part, retail buyers reported more concentrated purchases, with their top four suppliers providing from 85 to 97 percent of total purchases depending on the product. As retailers source from fewer suppliers, shippers will likely become more account-oriented in their marketing strategies, providing products and services tailored to the needs of specific large accounts. These trends may be consistent with greater payment of fees; as the value of the business generated by individual accounts grows, suppliers may feel increased incentives to comply with fee and service requests to gain or keep the business.

Both shippers and retailers agree that the incidence and costs of fees and services are increasing. Shippers are particularly alarmed at the rapid escalation in requests for new types of fees and services in the last 5 years. However, volume discounts, the most commonly requested fee type, are a longstanding trade practice, though today they are more prevalent and

costlier than before. When viewed together, the majority of the cost of fees and services was attributed to fees, with the provision of services often perceived to be less onerous than fees. In general, whether or not a fee or service was thought to be harmful to doing business depended on whether the shippers felt they received something in return. For example, when volume discounts led to increased purchases, they were often viewed as beneficial.

The most controversial fees are slotting fees. We found that shippers paid slotting fees (in this case defined as a fixed upfront fee for a new or existing product) only in the fresh-cut side of the produce industry, rather than the commodity side. No commodity firms interviewed paid slotting fees, although several had received requests and a few lost accounts for not complying. Commodity shippers fear that slotting fees will become standard practice in their industries now that they have been introduced into one section of the produce department. Although lettuce shippers did not pay slotting fees, they have felt the effect. Shippers paying slotting fees for bagged salads and also selling lettuce were thought to have an advantage over lettuce-only shippers because buyers were receiving, in effect, slotting fees on a bundle of products. Some bagged salad firms have shifted to selling private-label product rather than their own brands because slotting fees are not used in that segment of the industry.

Current concern focuses on the potential for slotting fees to enter the commodity side of the fresh produce industry. However, all types of fees can affect a firm's bottom line. Commodity firms did pay fees, and they are increasing. In 1999, fees of all types averaged about 1-2 percent of sales for most commodity shippers, but ranged from 1 to 8 percent for bagged salad shippers. Given low margins in the fresh produce shipping industry, these fees may be sufficient to determine whether a firm earns a profit or loses money over the course of a season. Hence, this research demonstrates that a focus on slotting fees is far too narrow when examining fees paid by shippers.

Many types of services are newer than the types of fees being requested. They were also more often viewed as beneficial and therefore, not surprisingly, were complied with more frequently. New services may reflect changes in the way produce is marketed, independent of retail consolidation. Shippers reported the most commonly provided service as third-party food safety certification. Requests for third-party food

safety certification reflect growing buyer awareness of the concerns of consumers and the business consequences when food safety is compromised. Requests for returnable plastic containers or pallets are explained by buyer efforts to reduce labor costs and cardboard refuse, rather than retail consolidation, especially since the request for this service is most prevalent among mass merchandisers rather than conventional retailers. Many shippers viewed this service as having a beneficial or neutral impact on their business.

Requests for private labels are related to the growing emphasis of some buyer types on improving customer loyalty and controlling quality, profitability, and volumes. Category management services were entering the fresh produce side of the grocery business prior to the latest wave of retail consolidation. With the adoption of standardized PLU codes and customer card data, it is possible to conduct more rigorous analyses of category profitability at the store level. This is even more important now with the increased number of produce items handled by retailers.

Some shippers appear to be struggling more than others to adapt to the emerging trade practices. Services, which are generally fixed costs, would naturally be higher as a percentage of sales for smaller firms. Smaller firms may find it difficult to compete with larger shippers in funding large investments for some services. On the other hand, retailers reported that they expect more fees and services from their largest suppliers for any particular product because of a perceived greater ability to pay. Smaller shippers already had begun to focus on niche markets prior to the recent consolidation and those that succeed will likely continue to target specialty markets of less interest to larger shippers.

From a public policy perspective, fees and services may be of particular concern if they are off-invoice and not reflected in publicly reported market prices, such as AMS' Market News reports. If so, public prices may no longer provide representative reference prices for all parties. In addition, publicly reported shipping-point prices based on daily sales will increasingly represent a lower share of actual transactions as firms move more to supply chain management practices, with ongoing bilateral contracts between buyers and sellers. The issue of whether shipping-point prices reflect current net prices may be more serious for products with a high incidence of contracts. Both buyers and sellers are concerned that with less information

about the net prices obtained by their competitors, they will be less able to make informed decisions about the extent to which they should make (retailers) or comply with (shippers) fee and service requests. As off-invoice fees increase, firms will need other sources of information on fees in order to negotiate competitive deals.

Why are fees and services increasing in incidence, magnitude, and type? What lessons can be learned from the experiences of the products studied here? A one-size-fits-all explanation is most likely a simplification. We can say that, in general, the relationship between shippers and retailers has changed, but only partly due to retail consolidation. Retail consolidation does not necessarily lead to market power. Market power may, indeed, play a role in new trade practices but that is an empirical question to investigate. Fees and services are also a function of several complex factors such as changes in consumer demand, technology, supply and demand conditions, shipper marketing strategies, buyer procurement strategies, the structure

of the shipping and retailing industries, and the level of interfirm rivalry.

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 about whether a practice is competitive or anticompetitive are based on both legal and economic precepts (see box, “Determining Anticompetitive Trade Practices”).

Another pressing question is whether slotting fees will eventually become common in commodity transactions. Bagged salad shippers, as sellers of a differentiated, branded product requiring dedicated shelf space year round, are more able to incorporate slotting and other types of fees into their pricing structures and may find that slotting fees can provide a benefit to their firms in terms of acquiring shelf space. In contrast, commodity shippers as price takers are less able to incorporate slotting and other types of fees into their

### ***Determining Anticompetitive Trade Practices***

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. According to the FTC, “A practice is illegal if it restricts competition in some significant way and has no overriding business justification. Practices that meet both characteristics are likely to harm consumers—by increasing prices, reducing availability of goods or services, lowering quality or service, or significantly stifling innovation.” Four laws regulate pricing: the Sherman Antitrust Act, the Federal Trade Commission Act, the Clayton Act, and the Robinson Patman Act.

The Sherman Antitrust Act, enforced by the Department of Justice, regulates horizontal relationships among firms, including price fixing, collusion, and other horizontal restraints. The Federal Trade Commission Act, enforced by FTC, also regulates horizontal firm relationships. The Clayton Antitrust Act, supplements the Sherman Act. These three Acts are designed to protect and preserve competition in the marketplace. The Robinson Patman Act regulates vertical relationships (those between suppliers and retailers), and prohibits retailers from paying suppliers different prices for like quality and quantity if the discrimination has a negative

effect on competition. Sellers are also prohibited from knowingly soliciting a discriminatory price.

Past antitrust court decisions have determined that certain practices are “per se” illegal, and firms can be prosecuted for adopting these practices. For example, price fixing is per se illegal. If authorities are able to prove that there is an agreement to fix prices, the firms involved can be prosecuted on the basis of the existence of the agreement. If, however, the defendants can demonstrate that the pricing strategy in question has created a better product or greatly reduced costs, the pricing strategy will be assessed under the “rule of reason.” Other questionable pricing strategies that are not per se illegal are also assessed under the rule of reason.

A rule of reason analysis assesses the overall social benefit resulting from the questionable practice. The first step is determining whether the pricing strategy is necessary to achieve these benefits. If so, the next question is whether the pricing strategy in question leads to the exercise of market power, resulting in prices above the competitive level. If prices do not rise above the competitive level, the final step is to assess whether the efficiency benefits outweigh the anticompetitive harm (Salop and Scheffman, 1997).

cost/pricing structures so incentives are low to offer slotting fees as a strategy for capturing market share from competing suppliers. Even if retailers have market power, it may be difficult to apply slotting fees to commodities unless and until they are available year round from a relatively consolidated shipper structure.

Hence, while current conditions in the commodity side of the business may not lend themselves to slotting fees, this may change. If more commodity shippers consolidate or form strategic alliances to match the needs of fewer, larger buyers and become year-round operators capable of supplying large, consistent volumes with the quality specifications desired by individual accounts, it may be easier for retailers to request slotting fees. However, if a consolidated shipper structure were to prevail, it is not a given that slotting fees would become the norm since countervailing power could help shippers resist these fees. The intensity of interfirm rivalry becomes critical at this point, with shippers either capable of resisting fees or offering them as a strategy for capturing market share from

competitors. On the other hand, if retailers focus on supply chain management approaches where they operate more in partnership with preferred suppliers, slotting fees may be less of a factor.

This report provides a first look at the complex interactions between shippers and retailers. By describing the trade practices and indicating broad trends, it provides a launching point for further hypotheses and research. Data will continue to be a stumbling block for future research. More comprehensive sampling would provide more confidence in results, but the proprietary nature of transaction data may preclude efforts to improve the information base.

The next report in this series will focus on whether retailers exert market power, based on an empirical analysis of the relationship between shipping-point and retail prices. This third report will provide further insight into the complex interactions between shippers and retailers.