Food & Marketing

Watsonville Coast Produce/Ed Young Photography

Changing Dynamics in Produce Marketing

The business relationship between produce shippers and retailers has recently gained national attention as retail consolidation increased. A large share of today's fresh produce is sold directly by shippers (often grower/shippers) to retailers, bypassing intermediaries and terminal wholesale markets. In the direct shipper-retailer transaction, price may be just one component of a more complicated sales arrangement. The shipper-retailer arrangement might also specify off-invoice fees to retailers in the form of promotional fees, rebates, or other discounts. And it might involve provision of various services such as use of plastic returnable cartons, automatic inventory replenishment programs, or third-party food safety certification.

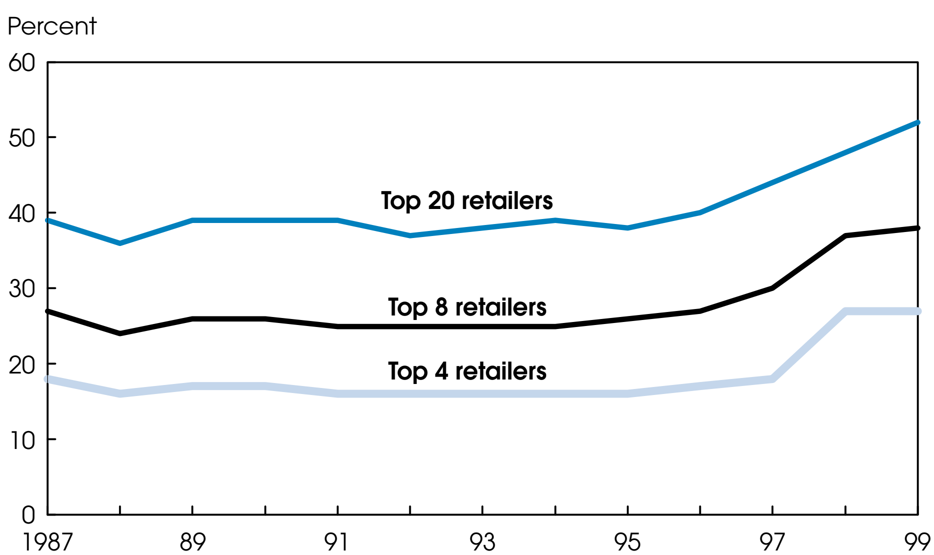
Hearings conducted by the Federal Trade Commission and the U.S. Senate Committee on Small Business during the past year provided a forum for industry leaders, government officials, and academics to present their perspectives on how the recent wave of supermarket mergers (*AO* August 2000) and growth of new trade practices have affected various industries, including the produce industry. While shippers expressed concern that recent retail consolidation has led to greater market power for some retailers and the growing incidence of retailer-requested fees and services, retailers argued that the new trade practices reflect their costs of doing business and the demands of consumers.

USDA's Economic Research Service (ERS) has examined the forces behind the changing dynamics of produce marketing and the evolving shipper-retailer relationship. Because public data on transactions between shippers and retailers are scarce, ERS conducted interviews of shippers, retailers, and wholesalers for information on marketing of grapes, oranges, grapefruit, tomatoes, lettuce, and bagged salads. While the small number of interviews demands caution in interpreting the findings, the research provides an important first step in understanding recent changes in produce marketing.

Factors in Shipper-Retailer Relationships

Some of the factors that underlie recent changes in the shipper-retailer relationship are shifts in consumer demand, technological innovation, and consolidation in retailing and produce shipping. Americans are annually consuming 49 pounds more fresh fruits and vegetables per capita in 1999 than in 1986, an 18-percent increase. They are also eating more food away from home, increasing the foodservice share of produce shipments (e.g., to restaurants and schools). In 1999, food away from home accounted for 48 percent of total spending on food, up from 44 percent in 1992 and 40 percent in 1982. Many retailers, faced with a declining

Top 20 Food Retailers Captured More than Half of Grocery Store Sales in 1999



Source: Monthly Retail Trade Survey, Bureau of the Census; company annual reports.
Economic Research Service, USDA

Marketing Channels for Produce Shipments Have Shifted

	Shippers reporting	Year	Market channel: Grocery retailers	Mass merchandisers	Wholesalers and distributors	Brokers	Food-service	Exports	Other	Value of sales
	Number		*Percent of total value of sales*							*$ million*
Grapes	9	1994	58	2	15	8	2	10	5	210.5
		1999	55	8	17	7	2	9	2	255.3
Oranges	9	1994	45	3	16	10	1	25	0	183.1
		1998[1]	44	9	14	6	2	25	0	228.9
Grapefruit[2]	8	1994	41	0	12	6	2	39	0	215.9
		1999	37	8	11	4	2	38	0	199.5
California tomatoes	10[3]	1994	26	2	40	21	6	3	2	222.3
		1999	25	2	37	17	15	2	2	235.9
Florida tomatoes	6	1994	23	0	57	3	4	13	0	103.6
		1999	3	3	67	4	13	10	0	121.4
Lettuce/bagged salads	10	1994	60	1	16	4	17	2	0	N.a.
		1999	61	3	8	3	23	2	0	N.a.

N.a. = Not available.
Results are based on a limited number of observations and must be interpreted with caution.
1. Because of a severe freeze in 1999, the analysis uses 1998 crop year. 2. Grapefruit exports reported by shippers differ from the industry report by the Florida Department of Citrus--i.e., 54 percent of fresh Florida grapefruit exported in 1994/95 and 59 percent in 1998/99. 3. Information on two repackers is included to provide a more accurate view of how tomatoes are marketed.
Source: USDA/ERS Produce Marketing Study, 1999-2000.
Economic Research Service, USDA

share of consumer food spending, are introducing more ready-to-eat meals, commonly referred to as retail Home-Meal-Replacement or Meal Solutions.

As produce consumption has increased, so has demand for variety and convenience. The typical grocery store carried 345 produce items in 1998 compared with 173 in 1987. New produce items include exotic imports as well as variations on standard products. For example, in addition to traditional mature green and vine-ripe tomatoes, consumers may choose from 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 considered seasonal as U.S. consumers indicate their willingness to pay higher prices for imported out-of-season fresh products.

As Americans spend less time preparing meals they eat at home, the convenience of fresh-cut produce has become more important. Fresh-cut produce is lightly processed (cut and/or packaged) perishable fresh produce such as broccoli florets, in comparison with unprocessed bulk produce commodities such as potatoes. Bagged salads (washed, cut, and ready-to-eat) 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, which are usually either branded or private-label products and need dedicated shelf space year-round.

New technology is transforming the shipper-retailer relationship as well. Information technologies have dramatically changed the amount and timeliness of information available. The advent of standardized price look-up (PLU) codes on unpackaged fruit and vegetable products (universal product codes on packaged grocery items were introduced earlier) makes retail sales data readily available, allowing for implementation of category (product) 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.

Investment in the human resources and technology necessary to analyze category information, however, may be difficult for smaller shippers to finance. As a result, shipper trade associations or 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.

Retail consolidation at the national level has sharply increased the sales shares of the largest 4, 8, and 20 U.S. retailers to 27 percent, 38 percent, and 52 percent, respectively. While food retailers have been consolidating, so have other produce buyers such as wholesalers that sell to

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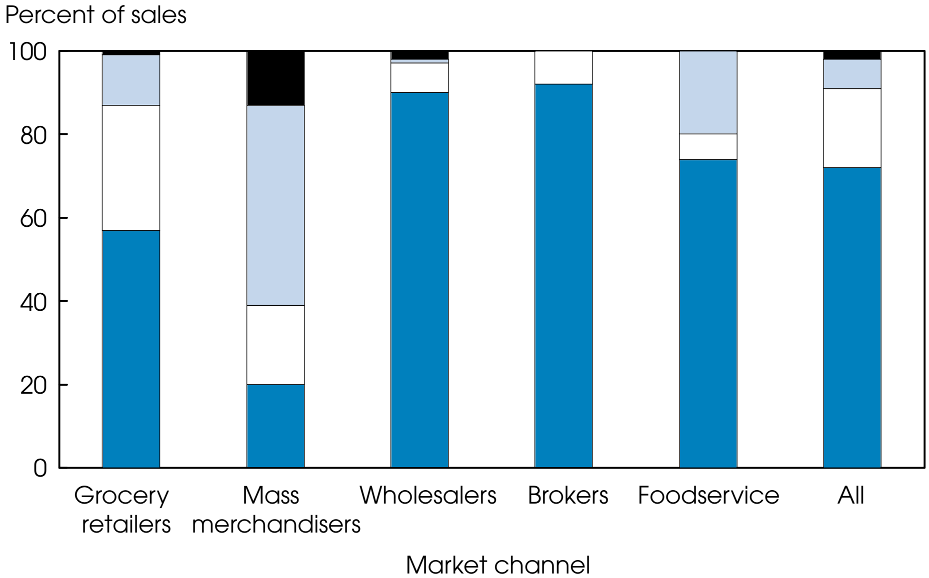
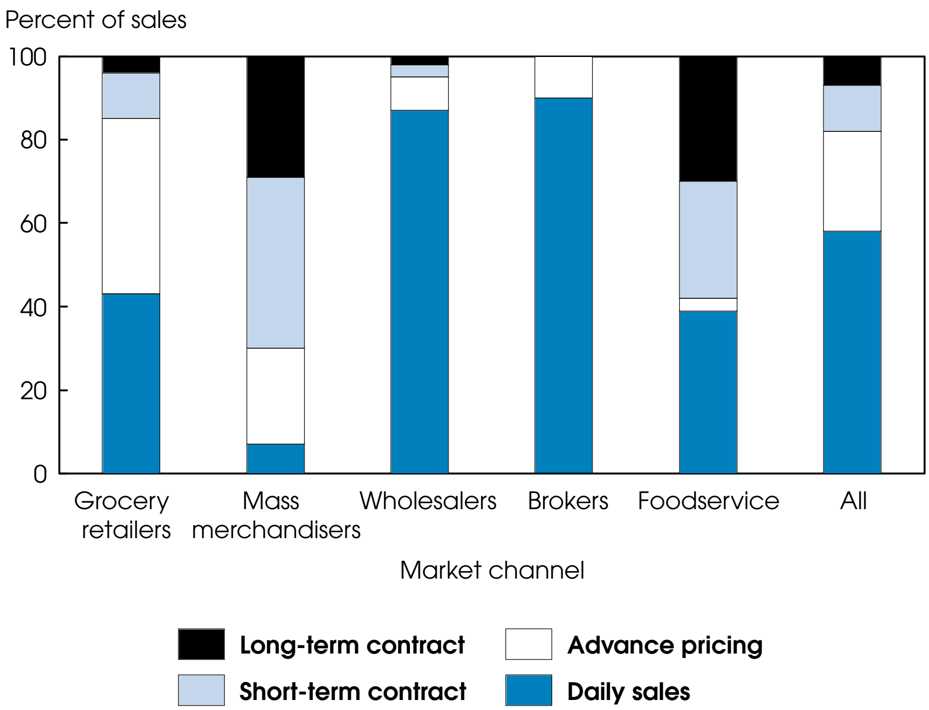
In 1994, Shippers Primarily Used Daily Sales Arrangements To Market Produce. . .



. . .But Long-Term Contracts Gained Share of Sales in 1999



Includes shippers of grapes, oranges, grapefruit, and tomatoes.
Source: USDA/ERS Produce Marketing Study, 1999-2000.
Economic Research Service, USDA

retail buyers. Retailers often cite the potential for lowering procurement, marketing, and distribution costs as motivating factors in mergers and acquisitions.

Along with consolidation, changes in retailers' buying practices can affect shippers. For example, some large retail firms reduce distribution costs by establishing automatic inventory replenishment programs with their suppliers. Using retailers' sales data, shippers are made 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.

Along with retailers, shippers are also consolidating. Large retailers require shippers large enough to meet their needs. Given the product diversity and seasonality of some crops, 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 each other and with shippers in other countries to meet retailers' more complex needs. However, providing a broader product line on a year-round basis can be risky and costly, given the high capital requirements involved in production and distribution of many fresh produce items.

Large supplier firms may be able to secure funds for these activities more easily than small firms, which favors consolidation and greater vertical and horizontal coordination in the produce shipping industry. They may also develop some countervailing negotiating strength in their relationships with retailers.

Consolidation and concentration in produce shipping is increasing but shows considerable variation among sectors. For example, not one of 149 California fresh grape shippers is estimated to have accounted for more than 6 percent of total industry sales in 1999. In contrast, the largest 4 of 23 California tomato shippers in 1999 accounted for an estimated 43 percent of sales. Although 54 bagged-salad firms nationwide sold to mainstream supermarkets in 1999, 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 volume of these firms may still be small relative to sales of the large retail chains.

Sales & Marketing Arrangements

Direct grocery retail sales (shipper to retailer) is the most important marketing channel for domestic sales of grapes, oranges, grapefruit, lettuce, and bagged salads, but not for sales of tomatoes. Marketing of tomatoes differs from the other produce in the study because they continue to ripen after they leave the shipper. Shippers generally sell tomatoes to repackers near final consumers, who then generate a uniform pack and sell to retailers, mass merchandisers, foodservice, or other intermediaries. The interview data indicate that the 1999 share of direct sales to retailers and mass merchandisers ranges from 6 percent for Florida tomatoes to 64 percent for lettuce/bagged salads.

Traditionally, the fresh produce industry has marketed primarily through daily sales arrangements—i.e., individual sales at the daily market price with no volume commitments over time. Variations in demand and supply (quantity and quality), both in season and out, generate price volatility for perishable products. Given constantly changing conditions, the flexibility of daily sales arrangements made sense. The challenge of managing price risk discouraged longer term arrangements, with sellers and buyers unwilling to go much beyond advance pricing.

In the fresh produce industry, advance pricing means establishing price ceilings a few weeks in advance for produce featured in advertisements. Advance pricing arrangements are not forward retail purchases, which entail a commitment to purchase. If the market price declines below the negotiated price ceiling, shippers generally have to lower prices to the current f.o.b. price because retailers usually have the option to buy elsewhere. Shippers commonly consider advance prices to be an unequal arrangement, reducing their ability to capture gains from potential market highs.

Based on ERS interviews, daily sales remain the leading, but declining, sales and marketing arrangement across all products in the study except bagged salads. In 1999, daily sales accounted for an average 58 percent of total sales of grapes, oranges, grapefruit, and tomatoes, down from 72 percent in 1994. Daily sales of lettuce accounted for 66 percent of total sales in 1999, with comparable 1994 data unavailable. Use of advance pricing arrangements for promotions has been growing, and it appears that the number of weeks for which maximum prices are fixed in advance has grown as well. Advance pricing increased from 19 to 24 percent of the total value of sales during 1994-99.

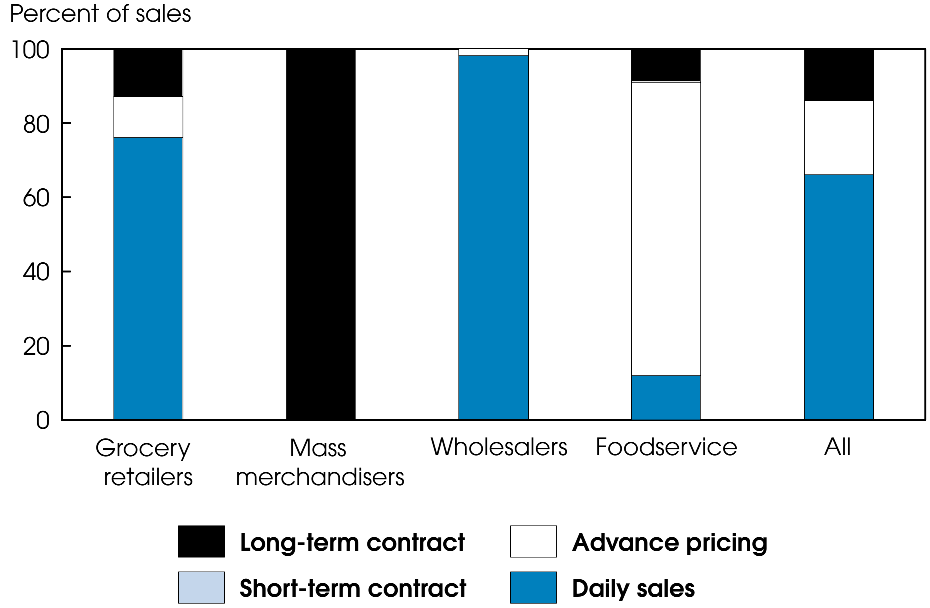
The volume requirements of very large produce buyers have created growing interest in more sophisticated coordination mechanisms than daily sales or advance pricing. For example, fresh produce sales of each of the top five U.S. retailers and mass merchandisers are in the multi-billion-dollar range, so relying on daily sales runs the risk of being unable to procure the volumes, sizes, varieties, quality, and consistency levels necessary. Furthermore, branded, fresh-cut products, such as bagged salads, require consistent, reliable, year-round availability and quality, making longer term arrangements—i.e., contracts—more desirable for both shippers and retailers.

The movement toward contracts appears to be led by mass merchandisers rather than by conventional retailers, although foodservice users are also becoming more involved. Shippers reported three main factors influencing their decision to enter into retail contracts: to ensure the market or sale, to maintain future relationships with buyers, and to achieve stable prices. While some shippers indicated they actively seek contract business with their customers, most engaged in contracting in response to buyer requests.

Between 1994 and 1999, use of short-term contracts (less than 1 year) for grapes, oranges, grapefruit, and tomatoes increased from 7 percent of total sales to 11 percent, while use of annual or multi-year contracts increased from 2 percent of total sales to 7 percent. Lettuce sales moving via long-term contracts were even higher at 14 percent in 1999.

Contracts—usually annual or multiyear—have become standard for the bagged salad industry. These written contracts specify price, quantity, advertisement periods, fees, and services.

Long-Term Contracts Dominated Lettuce Sales from Shippers to Mass Merchandisers in 1999



Source: USDA/ERS Produce Marketing Study, 1999-2000.
Economic Research Service, USDA

Emergence of Slotting Fees in the Bagged-Salad Industry

The changed relationship between shippers and retailers is due only partly to retail consolidation. Growth of the bagged-salad industry and the emergence of slotting fees in this industry illustrate the complex economic forces at work.

In the early 1990's, three separate trends converged to produce the new bagged salad industry: the continuing interest of consumers in more convenient product forms, the evolution of breathable films that preserve fresh-cut produce, and the desire of shippers to add value to and differentiate their products. Unlike bulk fresh produce commodities such as lettuce or tomatoes, bagged salads are produced and marketed much like other manufactured grocery products, available every week of the year and requiring dedicated year-round shelf space.

According to Information Resources, Inc. (IRI), bagged-salad sales grew rapidly in the early and mid-1990's and new firms entered the industry. In 1994 and 1995, year-to-year sales rose 49 and 32 percent. Sales growth continued into the late 1990's, although the rate of growth slowed to between 5 and 12 percent, and competition among shippers intensified. Slotting fees (upfront fees paid by suppliers to retailers to guarantee shelf space for new products) were adopted in the mid-1990's within this highly competitive environment as part of a market share battle between competitors eager to protect their investment in costly salad processing plants.

Retailers typically sell two or three brands of bagged salads, including retailers' private-label products. Many shippers strive not only to capture the business of retailers, but also to place specific products in stores. IRI data show that the number of lettuce-based bagged salad items in mainstream supermarkets increased from 202 in 1993 to 464 in 1999. As the new industry launched many new bagged salad products, retailers were also coping with a large increase in products in the rest of the produce department.

Retailers had used slotting fees in other areas of the grocery store since about 1984, even before the recent increase in retail consolidation. As bagged salads developed characteristics of manufactured food products, it would not have been surprising for retailers to request slotting fees for bagged salads. However, most shippers reported that it was bagged-salad shippers who first offered slotting fees as a means to garner market share from their competitors.

IRI data indicate that the number of bagged-salad shippers selling to mainstream supermarkets has declined from a high of 63 in 1995 to 54 in 1999. The share of bagged salads sold under private label, where no slotting fees are used, has increased from 2 percent in 1993 to 10 percent in 1999.

Now fees are sometimes offered by shippers and sometimes requested by retailers. Since retailers had already requested slotting fees for other products before the recent retail consolidation, these fees for stocking bagged salads may not necessarily be a function of retailers' market power alone, but rather a combination of product characteristics, interfirm rivalry in a capital-intensive sector, and the relative negotiating strength of buyers and sellers.

Fees & Services Tax Shippers

Almost all of the interviewed shipping firms reported that fee and service requests from buyers had increased. The exceptions were some tomato shippers, who indicated that buyers' requests were unchanged. The shares of fees as a percent of sales for shippers' top five retail and mass merchandiser accounts varied across product category. California and Florida tomato shippers had few retail and mass merchandiser sales and no fees at all in their top five accounts. Orange and grapefruit fees as a share of sales averaged 1.13 percent and 1.77 percent. Bagged salad firms reported that fees as a share of all sales (not just the top five retail and mass merchandiser accounts) ranged from 1 to 8 percent of shipper sales.

Of those paying fees, grape shippers had the lowest share of fees paid per sales on an account basis, 0.66 percent. The fragmented nature of the California grape industry may provide shippers with some protection from retailer requests for fees. Given an implicit need for retailers to spread purchases among more grape suppliers than among suppliers of commodities with more consolidated supply structures, retailers may be less inclined to charge certain fees.

While overall the ratio of fees to produce sales might appear low, it is important to remember that market prices are sometimes at or below total costs of providing the product, and may cover only variable costs. Consequently, these fees could be sufficient to eliminate profits or increase losses in periods of low prices, particularly for commodity shippers who act as price takers (i.e., they cannot raise prices without losing customers) and cannot pass along costs to customers.

The most frequently paid type of fee is the volume discount, a trade practice that has been used for years, but recently with greater incidence and magnitude. (For more on marketing fees, see article on page 16.) Shippers generally viewed this fee as negative or neutral in its impact on their business. Nevertheless, volume incentives have the potential to promote more stable relationships between suppliers and retailers; as a retailer buys more units from a 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 individual accounts.

Fresh produce shippers are particularly concerned about pay-to-stay and slotting fees. Slotting fees are fixed, upfront fees to retailers to guarantee shelf space for new products. Pay-to-stay fees are similar to slotting fees but apply to existing products. In the following discussion, pay-to-stay and slotting fees are considered together and referred to as slotting fees.

The recent emergence of slotting fees for certain kinds of fresh-cut produce—e.g., bagged salads and baby carrots—has led to shipper concern that they will soon become standard for other produce commodities as well. However, a key finding of this study is that this does not appear to be the case, at least so far. Thirteen commodity produce shippers reported receiving requests for slotting fees, but none of them paid the fees in 1999, although a few lost accounts for not complying. Despite the current high profile of slotting fees in the produce trade press, retailers agreed with shippers that such fees are not prevalent beyond the fresh-cut category.

Slotting fees are common for bagged salads and other fresh-cut branded products. While most lettuce/bagged salad shippers indicated that shippers initiated slotting fees in the mid-1990's in an effort to win new retail accounts and gain market share, a few reported that retailers initiated slotting fees. Now, slotting fees are both offered by shippers and requested by retailers. Retailers reported that slotting fees are associated primarily with branded categories such as bagged salads, baby carrots, and dried fruits and nuts. Retailers agreed that competition among bagged-salad suppliers for market share is intense and that payment of upfront fees is a way for shippers to obtain or expand shelf space.

None of the bagged salad shippers would reveal the exact size of slotting fees requested of or paid by their firms, but several discussed in general the use of slotting fees in the sector. For instance, shippers reported that annual slotting fees could range from $10,000 to $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.

Shippers of bagged salads pay slotting fees to retailers who guarantee to carry their product. In interviews, these shippers did not elaborate on any other commitments they might receive in exchange for fees paid. No firm mentioned slotting fees as a guarantee of a specified number of linear feet in refrigerated displays. A few mentioned using third-party or retailer scanner data to track sales in stores, but it is not clear if shippers have any recourse should volume of sales not meet expectations. In a few cases, when one retail chain acquired another, previous slotting fee agreements were not honored.

Not all retailers request slotting fees or accept them, even for branded, fresh-cut products. Instead, some retailers focus on gaining the efficiencies of handling relatively high-volume products by negotiating long-term agreements with suppliers and then requiring these preferred suppliers to provide services such as automatic inventory replenishment, use of returnable containers, or other special packaging.

Services requested by retailers, or offered by produce shippers, are also on the rise. New services such as third-party food safety certification are quickly becoming the norm as shippers respond to changing consumer preferences.

Several services, such as electronic data interchange and category management programs, derive from new scanner technology that provides both shipper and retailer with more timely market intelligence, which could reduce costs and increase profits. Some of these new technologies impose high fixed costs and so may pose a competitive disadvantage to smaller shippers, and some fees and services may raise shippers' costs without providing benefits of equal value.

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