



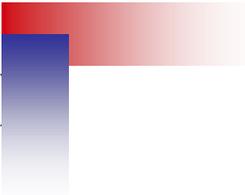
The US Food Distribution System: Concepts and Evolution

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A Chapter in “Food Systems & Public Health” Textbook (Johns Hopkins University Center
for a Livable Future)

*“Developing and Eastern Broccoli Industry”, Webinar Series
May 6 2013*





Objectives

Understand the history of the U.S. food distribution system and its evolution

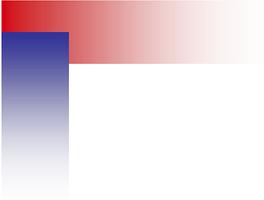
Describe why distribution channels and marketing intermediaries are used

Understand the different marketing intermediaries

Review the emerging direct market channels and their role

Examine channel behavior and organization (channel segmentation, private label, price transmission)



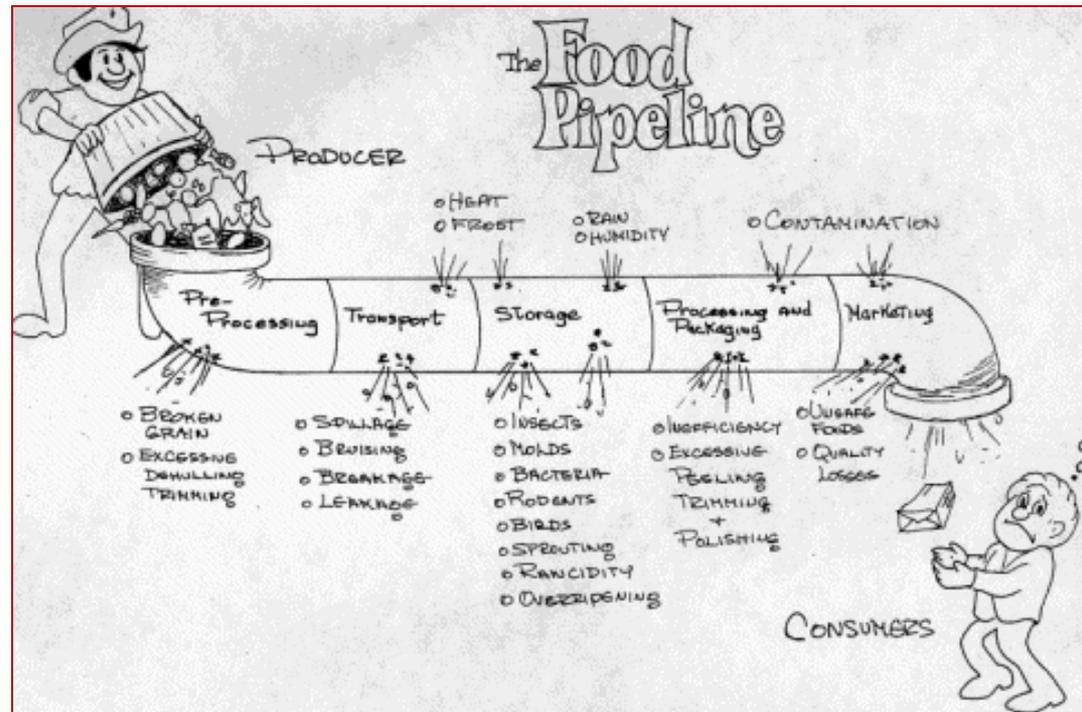


PRIMARY SEGMENTS OF THE FOOD DISTRIBUTION SYSTEM



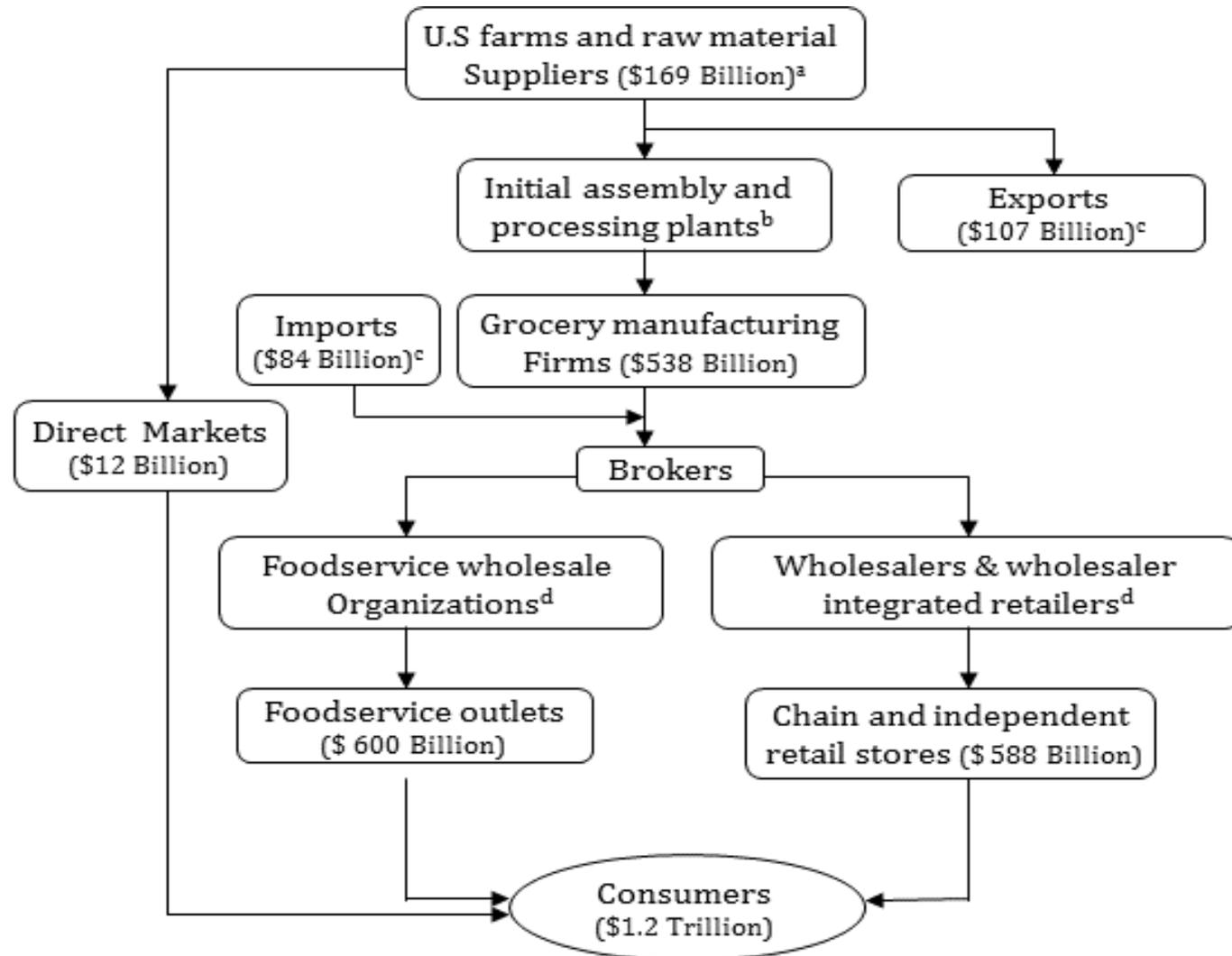
Primary segments of the food distribution systems

- Agricultural Production
- Assembling and processing plants, and grocery manufacturing firms
- Food brokers
- Food Wholesalers
- Food Retailer Stores
- Foodservice Outlets
- Direct Markets



The U.S. Food Distribution System (2010)

- Food distribution system employed about 13 percent of the total U. S. civilian workforce
- The total value of food purchases by U.S. consumers in 2010 was about \$1.2 trillion



Agricultural Production

- Includes the cultivation of animals, plants, fungi, and other life forms for food, fiber, and others
- The farming sector today is highly **concentrated**
- Large-scale farms account for less than 10 percent of all farms but two-thirds of agricultural production.



Assembling and Processing Plants

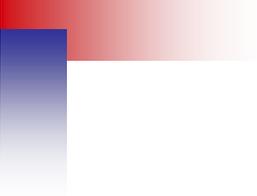
- Transform livestock and agricultural products into products for intermediate use or final consumption
- Food is one of the United States' largest manufacturing sectors -10% of all manufacturing shipments
- Large multinationals account for 36 percent of jobs and they represent only 500 of the 28,000 establishments
- Eighty nine percent of establishments employ fewer than 100 workers



Food Brokers



- Act as food manufacturers' representatives and facilitate sales between manufacturers and retailers
- Sometimes more cost-effective for food manufacturers than paying an internal company salesperson
- There were over 6,000 food **broker** companies in the U.S. in 2007
- Customers normally include a mixture of retail stores as well as independent and chain wholesalers.
- Earn a commission of approximately 3-5 percent



Food Wholesalers

- There are two types of food wholesalers:
 - Merchant wholesalers.** Buy and resell food, assemble it for distribution, load it for transport, and deliver it to customers like supermarkets, food service establishments, or the export market
 - Manufacturers' sales branches and offices.** Represent 22 percent of total wholesale food sales. Typically separate from manufacturers' plants and are focused on marketing
- Sometimes classified according to the product line they carry, such as specialty (e.g., produce and dairy)

As retail food stores evolved into supermarkets they splintered into numerous store types

One contemporary typology separates U.S. retail grocery stores into three channels: traditional, nontraditional and convenience stores

By 2010, traditional supermarkets accounted for about 40% of retail grocery store sales but have lost considerable market share

The difference today is mostly accounted for by a variety of so-called nontraditional formats that tend to be much larger and price-oriented:

supercenters (17.2%)
convenience stores (15.1 %)
wholesale clubs (8.5 percent)
drug stores (5.5 percent)
dollar stores (2.2%) and



Food Retailer Stores

Retail Store Numbers, Dollar Share and Sales, Grocery and Consumables, 2011

Format	Number of Stores	Dollar Share	Annual Sales (millions)
Total Traditional Grocery	40,229	46.7%	\$500,972
Traditional Supermarkets	26,345	40.1	429,993
Fresh Format	911	1.0	10,367
Limited-Assortment	3,730	2.7	28,609
Super Warehouse	542	1.9	19,876
Other (Small Grocery)	8,701	1.1	12,126
Total C-Stores	154,373	15.1%	\$162,351
Convenience (w/gas)*	125,333	12.9	138,807
Convenience (w/o gas)	29,041	2.2	23,544
Total Non-Traditional Grocery	55,683	38.2%	\$410,315
Wholesale Club	1,331	8.5	91,100
Supercenter	3,609	17.2	184,248
Dollar Store	24,512	2.2	24,031
Drug	22,534	5.5	58,659
Mass	3,518	4.4	47,222
Military	179	0.5	5,054
Total All Formats	250,285	100%	\$1,073,639

*Does not include gasoline sales

Source: Willard Bishop, Competitive Edge, "The Future of Food Retailing," June 2012

Food Service Outlets



- Preparation and service of food outside the home
- Comprises just over 50% of total food spending, marginally higher than from retail stores
- Segmentation has been the rule for many decades.
- Often divided into two categories: commercial 80% (e.g., restaurants) and non-commercial or institutional (e.g., education, military)

Direct Markets



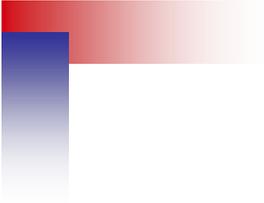
- U.S. consumer interest in local/regional foods has increased sharply in recent years.
- Estimated to be approximately \$12 billion in 2011
- About half of local foods are sold through retail and foodservice outlets, and half through direct to consumer marketing - farmers markets, U-Pick operations, and Community Supported Agriculture programs
- The number of farmer markets increased from less than 2,000 in 1994 to nearly 7,000 in 2011

Blurring Boundaries



- Retailers of all formats understand that food is a regular need.
- Rapidly growing sales of in-retail store restaurants and prepared meals for take-out from supermarkets
- At the same time, restaurants are also offering more take-out food for at-home consumption





EVOLUTION OF U.S. FOOD DISTRIBUTION



Ownership Structure



- Agricultural producers are caught in the middle.
- In 2007, 2.2 million commercial farmers and only an estimated 138 supermarket chains - sellers outnumber buyers 16,000 to 1
- In 2002, there were 33 percent fewer fluid milk processing plants than a decade earlier, processing 46 percent more milk per plant
- The number of U.S. hog farms dropped from 260,000 in 1990 to 60,000 by 2010
- in 1972, the top 50 food processors accounted for 39 percent of sales but by 2007 they accounted for 51%

Case Study 1: The Impact of Walmart

- Incorporated in Bentonville, Arkansas in 1969 by Sam Walton
- “Supercenter” to facilitate “one-stop shopping,” with grocery products and fresh foods all under one roof
- By 2011, Walmart had passed the multinational oil companies to become the world’s largest company (2012 revenues: \$444 billion).



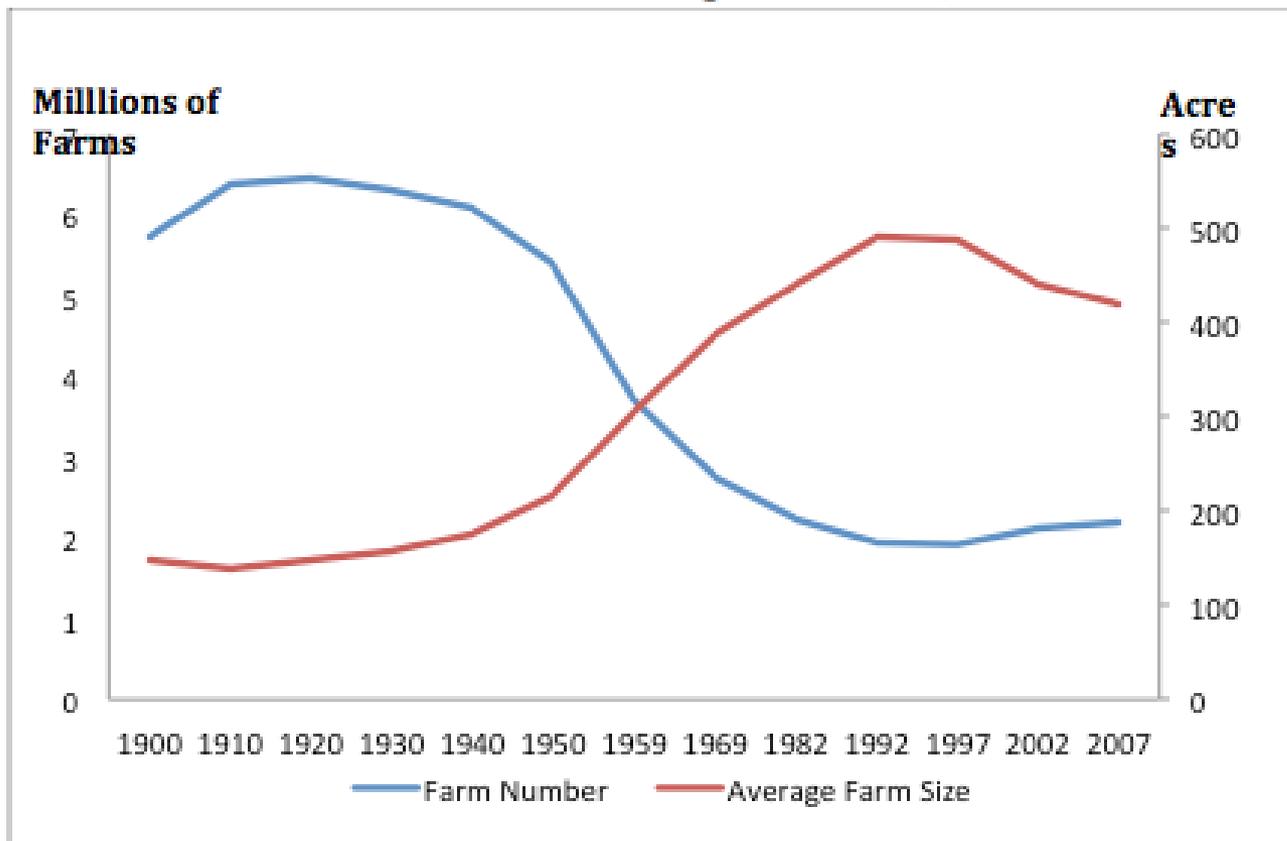
Case Study 1: The Impact of Walmart

- Huge contribution to productivity gains for the entire U.S. economy come from Walmart efficiencies
- Studies show that Walmart is 8 percent to 27 percent lower priced than at large supermarkets...
- ... but critics claim economic and social abuses, including sub-standard wages
 - Walmart entry eliminates three local jobs for every two it creates
 - Reduces the sales of existing supermarkets and variety stores by 10 to 40 percent
- Community groups and labor unions contend that Walmart's entry destroys many local small businesses
- The policy challenge of increasing economic concentration is balancing the trade-offs between consumer benefits and



Farming Sector - Evolution

Number of Farms and Average Farm Size, 1900-2007



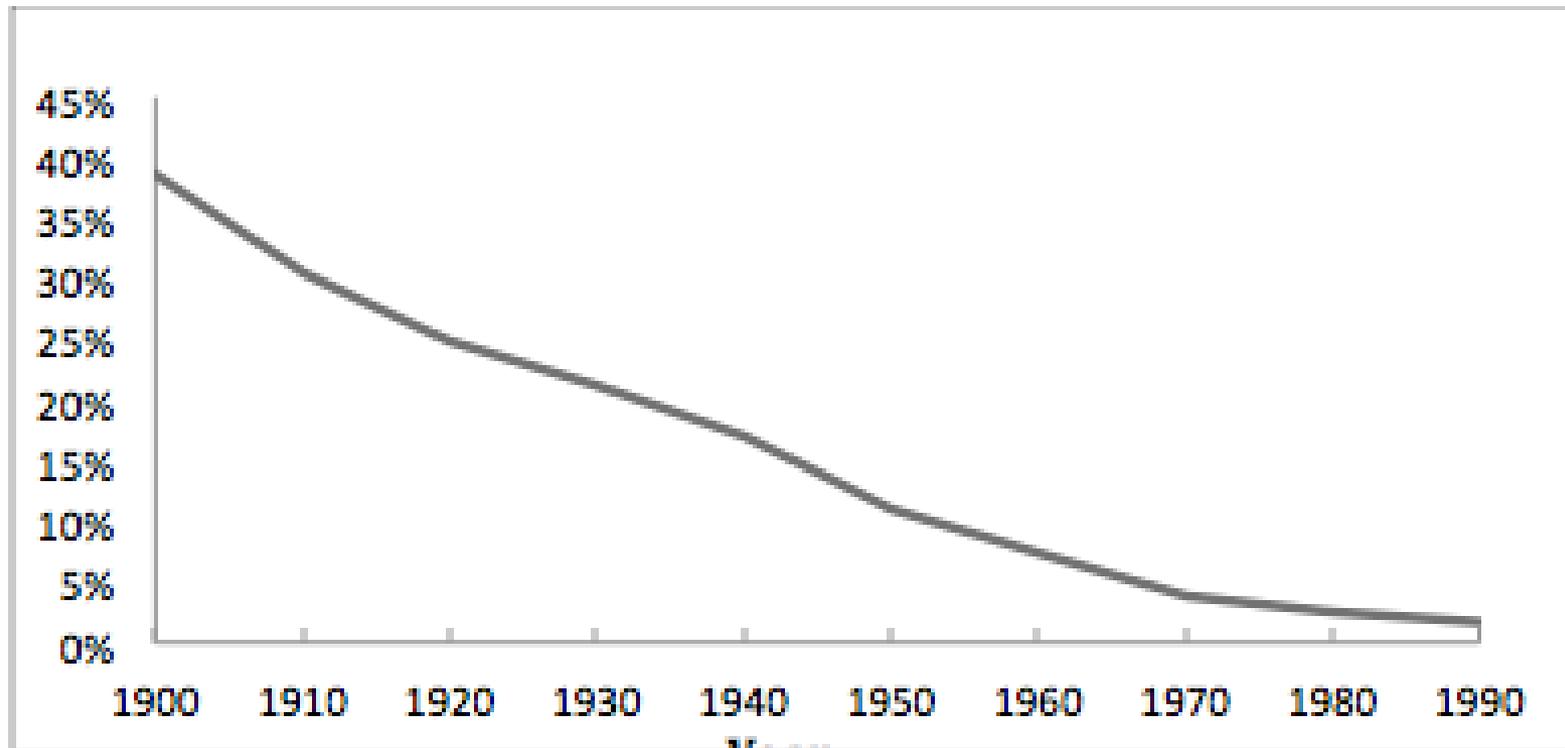
Source: National Agricultural Statistics Service, Trends in U.S. Agriculture

http://www.nass.usda.gov/Publications/Trends_in_U.S._Agriculture/Farm_Population/index.asp (accessed 3/11/2012).

- Rapid increases in agricultural productivity occurred, as new farming methods led to a move away from fragmented, multiple enterprise farms to larger and more specialized operations

Percent of U.S. Labor Force Working on Farms, 1900-1990

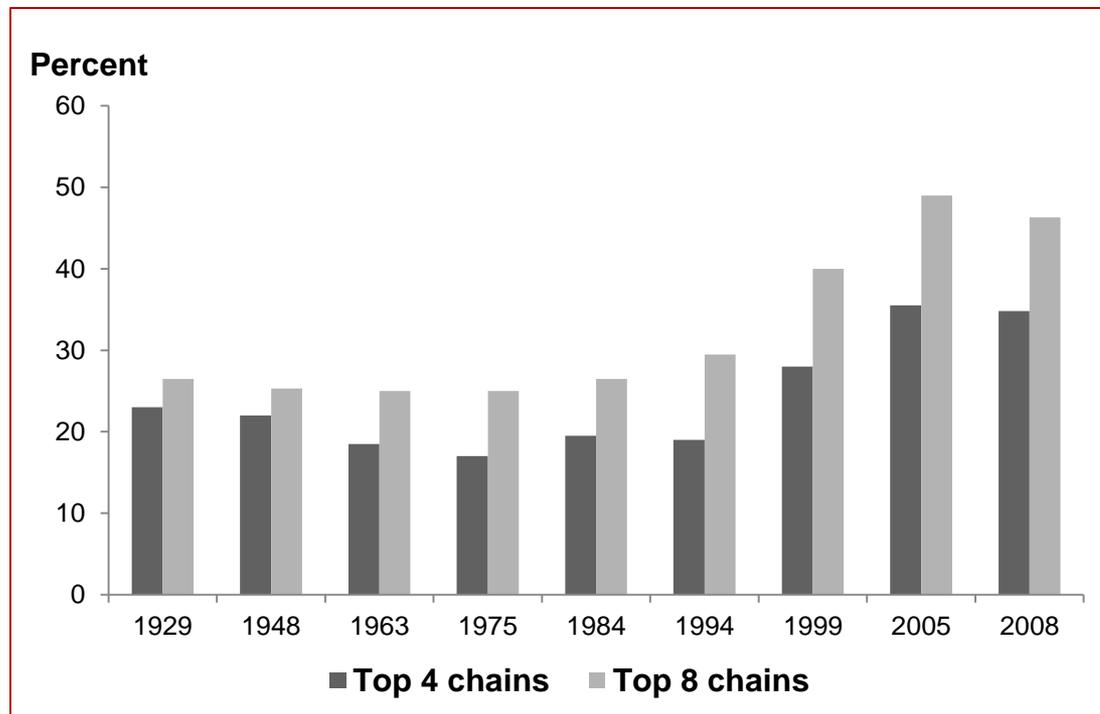
- Greater farm output was achieved with ever-smaller labor investments



- New structure derived in challenges in achieving efficiencies and in the reduction of distribution system waste.

Retail Stores Evolution

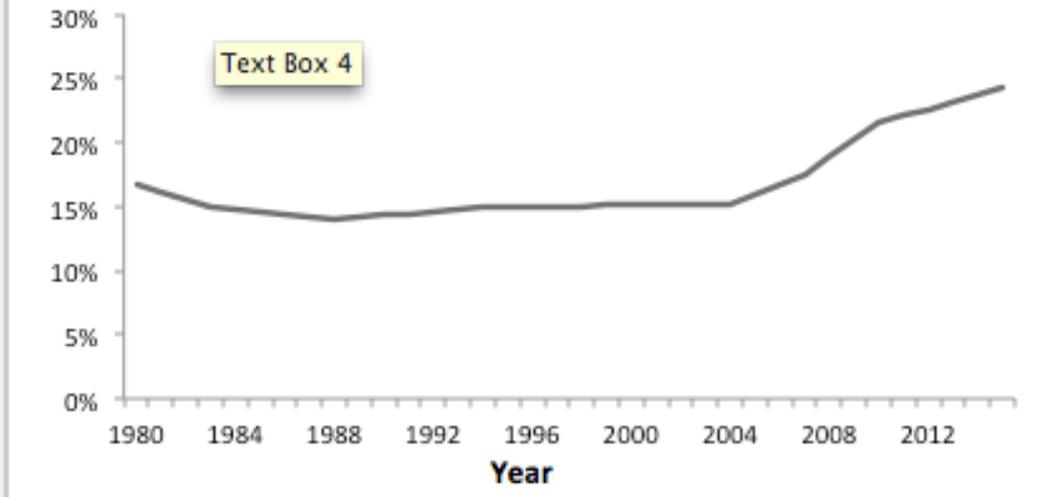
- As labor became more expensive and consumers began to demand “one-stop shopping,” a revolutionary type of store was conceived.
- Supermarket was among the most important developments in the U. S. food distribution system in the past 100 years
- Market Shares for U.S. Grocery Chains, 1929-2008:



Case Study 2: Private Label in the U.S Supermarket

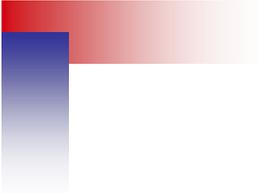
Private Label penetration in the U.S. Supermarket Sector

USA: Private Label Penetration



Source: Food Industry Management Program, Cornell University.

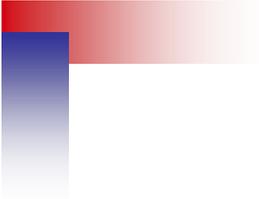




Case Study 2: Private Label in the U.S Supermarket

- Manufacturers - limited advertising and are willing to sacrifice margin for volume and predictability from retail customers.
- Retailers are able to offer these lower cost goods at lower retail prices.
- Since only some of the lower cost savings are passed on to consumers, retailers enjoy more robust margins
- Private label products help to build their own retail brand image





Case Study 2: Private Label in the U.S Supermarket

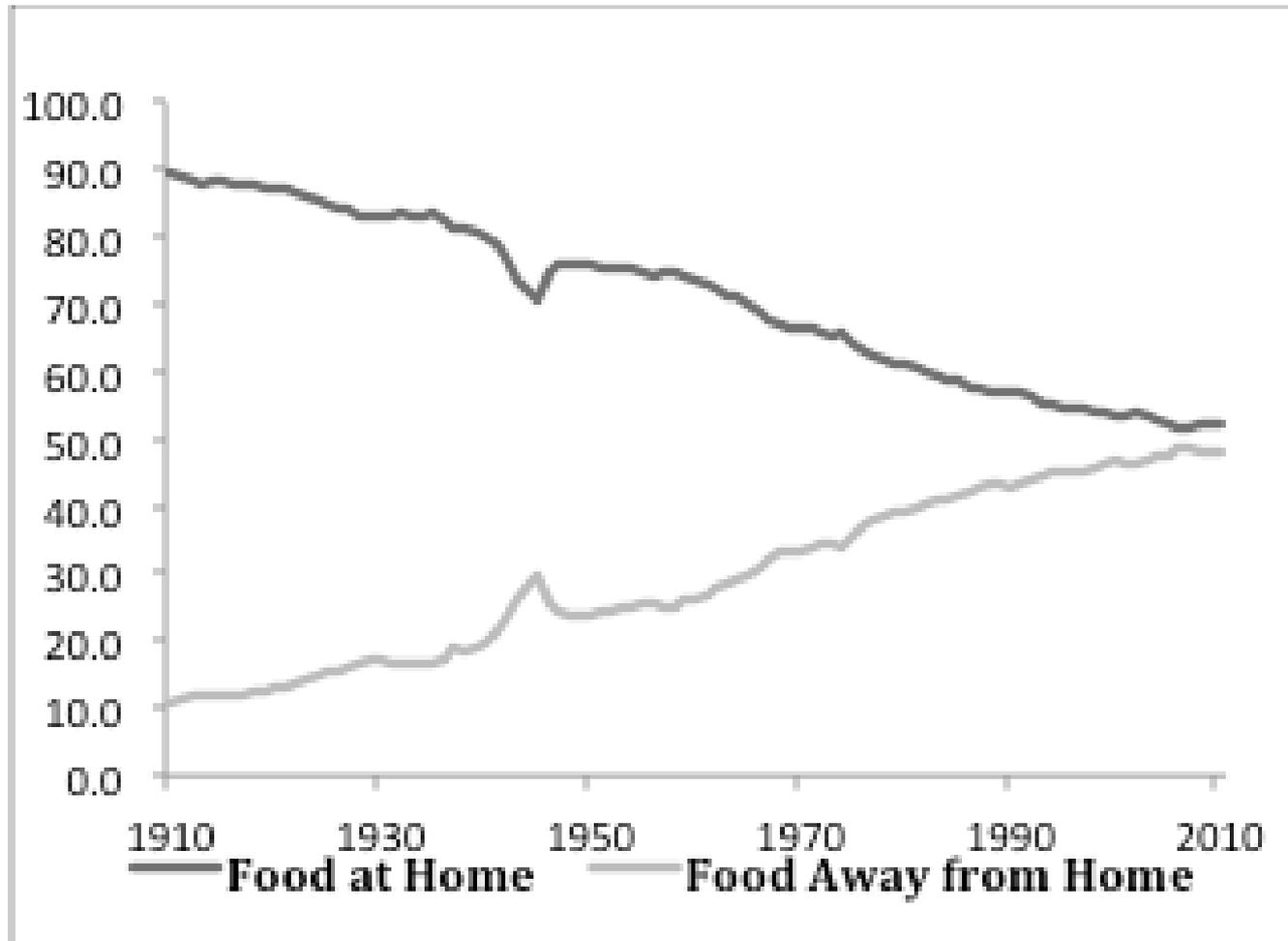
Consequences:

- Consumers gain access to prices ranging from 20 to 50 percent lower than the national brand equivalent.
- Today's national brand manufacturers view retail private label initiatives as a threat
- However, certain suppliers actually benefit from retailers - those who produce the private label products



Foodservice Evolution

Allocation of Food Expenditures by Channel, 1910-2010





The Role of Marketing Channel Intermediaries

Demand side:

breaking down a heterogeneous supply (e.g., a citrus packing plant sorts oranges according to grade and sizes)

accumulation (e.g. a wholesaler aggregates food products into larger homogenous lots)

allocation (e.g., re-routing product supply to various wholesalers and retailers)

assorting (e.g. wholesalers combine foods from different sources to supply a supermarket's produce department)

Supply side:

routinizing (e.g. agreement on the mode, amount, and timing of payment without dealing with multiple buyers)

Case Study 3: Price Transmission

Why retail prices do not appear to move in concert with changes in supply prices?

- Farm gate prices for vegetables vary considerably due to seasonality, while retail prices exhibit modest or infrequent variations

Six reasons:

1. Retailers do not set their prices based on production price; they rely more on **local competition**
2. **About $\frac{3}{4}$ of all consumer food spending** goes to cover **marketing** - supply price can change considerably but has little impact



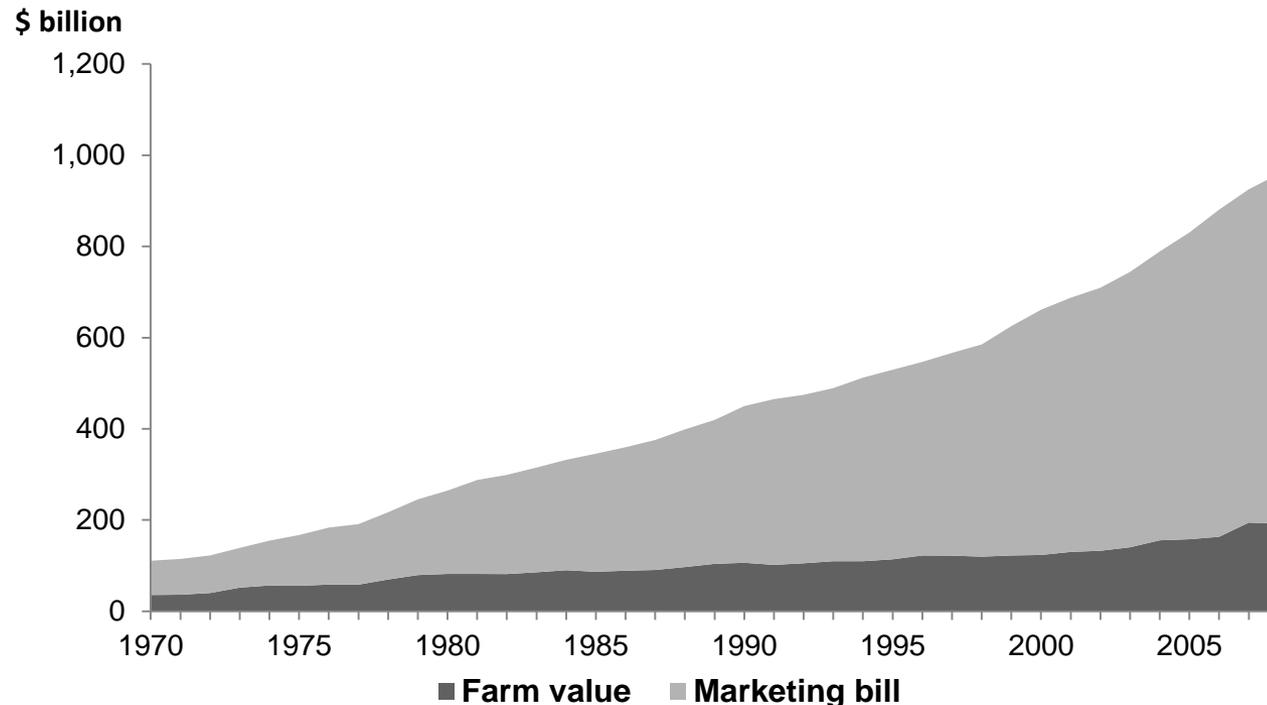
Case Study 3: Price Transmission

3. Conventional retail assumption is that **consumers do not like price changes**, except for retail price promotions (sales)
4. To be effective, **price reductions must be perceived** by consumers - by 2011, the average supermarket carried over 38,000 products
5. Foodstuffs are characterized by an “**inelastic price elasticity of demand**” - sales are not very sensitive to price changes
6. The retailer's objective is not to **maximize sales and profits** of each department separately, but of the **entire store**.



System Trends in Consumer Expenditure

- Allocation of U.S. Consumer Food Expenditures 1970-2008



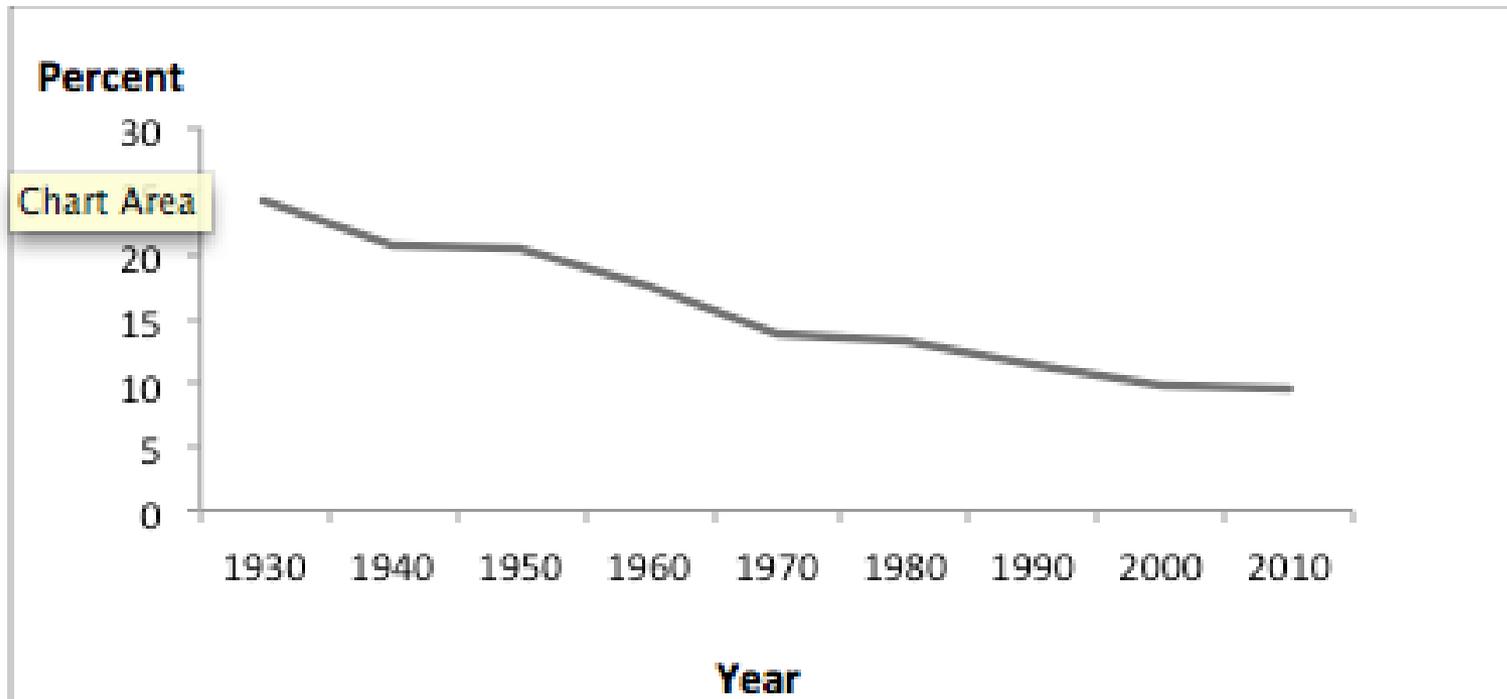
- Expanded role of “marketing activity,” - all post-farm-gate functions such as transportation, packaging, financing, energy, labor, processing, advertising, wholesaling and retailing.



System Trends in Consumer Expenditure

- Percentage of income that consumers allocate for food has decreased, leaving more disposable income to other areas.

U.S. Food Expenditures 1930-2010 (as a percentage of disposable income)



Source: Economic Research Service, U.S. Department of Agriculture, *Food Expenditure Tables*

The share of income spent on food has been reduced in part because real household incomes have improved with more women working and contributing to the household's income.

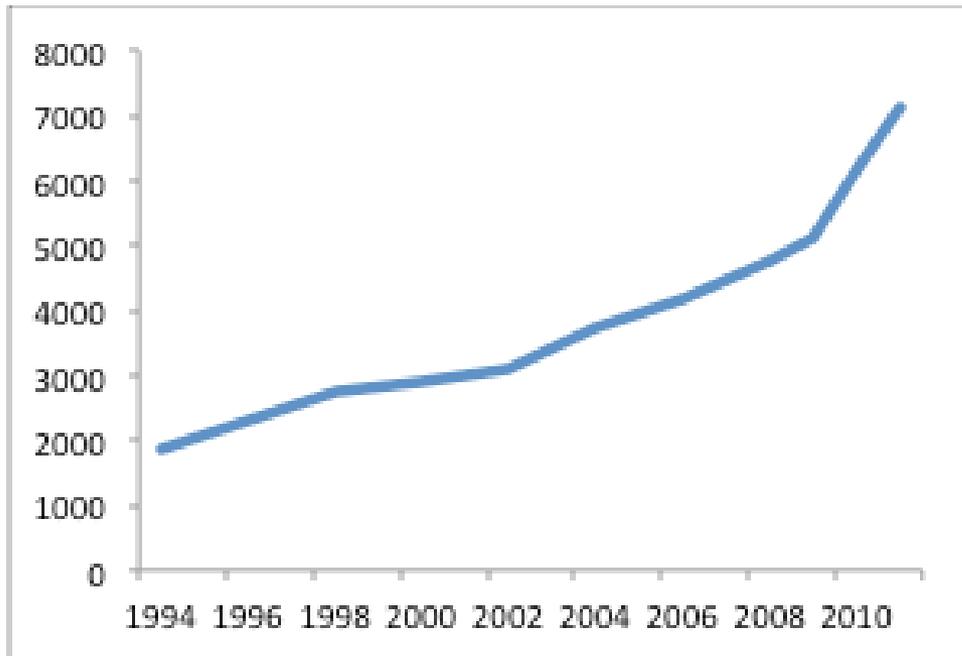


However, it may be also argued that reducing the share of income spent on food wrongly encourages policies that are low cost at the expense of the environment, food safety and health.



Direct Marketing and Locally/Regionally Grown Foods

- Accounts for one percent of total domestic food sales, however, is the fastest growing segment of the U.S. food system.



- In 2010 about half of locally grown fruit and vegetable sales were marketed directly to consumers.
- Many supermarkets seek to satisfy new customer demand for local foods as an opportunity to increase customer loyalty.



Direct Marketing Advantages/Disadvantages

- Preserving local landscapes and family farms
- Strengthening local and regional economies
- Provide food's origin information to the customer
- Some farmers are able to obtain greater gross revenue by selling their goods via direct marketing

- Not clear that consumers will be willing to pay greater food **prices** for a more complete cost accounting
- Patronizing numerous local food outlets may destroy potential economies of scale
- Production seasonality often limits year round availability of local and regional food
- At least in the short term, locally marketed food frequently lacks the public and private infrastructure

Case Study 4: The Growing Phenomenon of Community Supported Agriculture (CSA)

- CSAs are networks of consumers and local farms that share risks and benefits of food production
- Each member makes a payment at the beginning of growing season for a share of the expected harvest, and they receive weekly shares.
- But unlike farmers markets, CSAs do not require retail space and they have extremely flexible distribution systems.



Case Study 4: The Growing Phenomenon of Community Supported Agriculture (CSA)

- Some sell strictly what they produce, while others source from other farms satisfying certain conditions
- Some prioritize home delivery for example through an online ordering site
- Some supermarkets endorse them CSAs to use their parking lots. CSA shoppers may need to supplement their CSA purchases at the supermarket.



The Future of Retail Food Distribution

These executives project that:

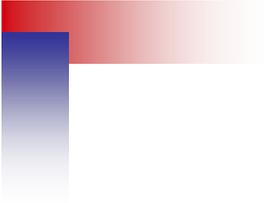
Marketing health and nutrition will become ubiquitous for supermarkets by 2015

New store formats will be smaller with higher sales productivity

Dollar stores will be the most significant threat to conventional supermarkets, as they begin to carry fresh foods.

Retailers will demand more supplier-funded promotions (e.g. funds for in store advertising and off-invoice allowances) as opposed to media advertising to support brands





THANK YOU!
Questions? Comments?

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