TRENDS IN FOOD WHOLESALING AND RETAILING

- Provide a wide range of food to consumers at many different places, many different times…
- Food retailers include supermarkets, bakery shops, department stores, gasoline filling stations, stop-and-shop convenience stores, fast-food shops, full-service restaurants, vending machines…
- Sector has changed dramatically, even recently.
- A huge number of market agencies (see Fig. 6.1)
- A complex network of relationships between processors, wholesalers and retailers.
- To efficiently assemble various products in reasonable quantities from the shipping point firms and processors and sell them in smaller quantities to retailers.

**Example**  A chicken broiler processor may produce 10,000 chickens a day and a Hy-Vee will sell at most 150 chickens a day!

→ Need for a middleman.

- Food wholesaling accounts for 10% of the consumer's food expenses!
- Food wholesalers do not sell to consumers.
MERCHANT WHOLESALERS: Buy, sell and store grocery products and perform other marketing functions like inventory control, pricing, financial management and analysis, private brand and label programs, credit and financing of new stores, and store site selection.

- Merchant wholesalers represent 69% of wholesale food sales.
- Product line may differ. Specialty-line food wholesalers are smaller in size but more numerous. (See Fig 6.2)
- In the past, independent food wholesalers were important, but their position has been challenged by food retailing chain.

**Idea:** Set up a group of retailers who will buy from the same wholesaler who himself belongs to a chainstore company.

→ The chain of stores make large purchases and control wholesaling.

→ Chainstores became very competitive.

Strategic response of independent retailers was to develop affiliations with independent wholesalers.

**Idea:** Replicate what the chainstore achieved with a different ownership structure (agreements and contracts).

**NEW TYPES OF FOOD MERCHANT WHOLESALING ORGANIZATION**

- Foodservice distributors supply products and services to restaurants, fast food outlets, airlines, and food service institutions.

- Wholesale buying clubs developed in the 70's evolved towards retailing but sell big quantities to consumers at a low unit price. A costly membership is required!

**Example** Entry fee and consumer surplus extraction: A retailer is willing to sell two goods. A marketing study finds that there are two kinds of consumers. Resale between consumers is impossible (non-anonymous warranty).
OPTIMAL PRICING STRATEGY?

Exclusion: Sell Good 1 and 2 at price $P = $200

→ \{ Consumer 1 does not buy Good 2
     Consumer 2 does not buy Good 1 \}

\[ \pi_E = 1 \times $200 + 1 \times $200 = $400 \]

No Exclusion: Sell Good 1 and 2 at price $P = $120

→ Everyone Buys
\[ \pi_{NE} = 2 \times $120 + 2 \times $120 = $480 \]

What other pricing strategy could you implement?
CREATE A MEMBERSHIP

Problem: Find the optimal level of membership fee:

Suppose MF = $40 and P = $120.

Will the consumers participate?

Consumer 1 pays $40 + 2 \times $120 = $280 < $320

He agrees to buy a membership.

\[ \pi = 2 \times $40 + 4 \times $120 = $560 > \pi_{NE} > \pi_E \]

- Membership fee is a particular example of "non linear" pricing.
- Prices are non linear because the unit prices differ when the quantity purchased increases.

Example: If Consumer 1 buys

<table>
<thead>
<tr>
<th>Unit Purchased</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unit Price</td>
<td>40 + 120 = $160</td>
<td>( \frac{40 + 2 \times 120}{2} = $140 )</td>
<td>( \frac{40 + 3 \times 120}{3} = $133.34 )</td>
<td>( \frac{40 + 4 \times 120}{4} = $130 )</td>
</tr>
</tbody>
</table>
- Non linear prices are generally superior for extracting consumers' surplus than linear prices if and only if consumers cannot resell the good themselves!

- Linear pricing, on the other hand, is "resale proof."

**Example:** In the exercise, compute the profit if resale is possible and costless.

\[ \pi_{RES} = 1 \times 40 + 4 \times 120 = 520 < \pi_M \]

- Wholesaling and retailing are often "integrated" by the firm.

**Example:** WalMart, K Mart, or Target purchase directly from manufacturers and their own private label foods.

- The reverse is also observed, when manufacturers develop "sales branches" and "sales offices" and become de facto wholesalers.

- Wholesale agents and brokers usually do not take title to products and are paid a commission for their services.
  - They find clients for processors
  - Advise them about pricing strategies

- Market share of agents and brokers tends to decrease
  - This function is performed by processors or retailers
Trends in Food Wholesaling

- Stable number of wholesalers

- Average size is increasing

- In the 80's - food wholesaling mergers

  → Table 6.1

- The eight largest general-line merchant wholesalers' share of food sales increased from 22% in 1977 to 44% in 1992.

- Decline of independent wholesalers.
Changes in Food Retailing

- Food stores are evolving over time
  - Food chainstore movement
  - Supermarkets

- Between 1960 and 1997, the number of food stores fell by 32%.

- In the same time, average sales per store rose from $200,000/year to $2.5 million/year
  - See Table 6.3
The Food Chainstore Movement

- Chainstore ≠ Supermarket

- Chainstore needs at least 11 retail stores

- First chainstore appeared in 1958. By 1979, food chains reached their max. number of outlets.
  - Kroger Co. had 5,575 stores in 1979
  - Kroger has 3,062 stores today

- Can you explain this trend?
  - Competition to offer a rich diversity of products

- Chainstores have both a vertical and a horizontal affiliation.
  - Vertical integration of wholesaling activities and even processing activities!

- Chainstore market share has steadily increased during the last 40 years.
  - Fig. 6.5

- To summarize: Food retailing has essentially three segments.
  - Corporate chainstore (centrally managed) (Kroger, Winn-Dixie, Safeway)
  - Affiliated independent chainstores (independently owned but have affiliation with food wholesaler)
  - Independent, unaffiliated food stores with no special relationships with wholesaler
The Supermarket Movement

- Food chainstores
  → Need to achieve economies of scale in wholesaling

- Supermarkets
  → Need to fulfill client's needs (consumer-driven)

- Important characteristics: self-service  
  cash-and-carry  
  full-line  
  departmentalized

- 1st supermarkets were developed by independent grocers, NOT by chainstore managers.

- The superiority in numbers of supermarkets over other forms of food retailing peaked in the 1950's.

- Huge diversity of food stores
  → Importance of differentiation
  → See Fig. 6.6

- Preferences of consumers regarding food stores
  → See Table 6.4

- Pricing in food retailing
  → "Market Basket Pricing"

  Total dollar sales must cover retail operating costs + costs of purchased merchandise. As long as this constraint is met, the manager has complete latitude to fix prices and prices may not reflect their real cost (i.e., purchase price) for the retailer.