Balance of Power

By
Ed McLaughlin

The hottest question in the food industry today is: "with the unprecedented increase in global consolidation at retail levels, how can we compete?"

Of course, the question has a number of sub-questions: "will the consolidation continue? Will this new generation of super-retailers change forever the rules of food industry business practices?" And, "how will we survive?"

Let's examine the evidence. The eventual winners and losers of this altered industry structure are not, perhaps, apparent.

First, it is true that retail concentration — the term economists use to measure the intensity of competition in a given market — has increased in the U.S. over recent years to now historic highs. Retail consolidation occupied the headlines in the business press for a great part of 1998. A few of the major deals in the U.S.:

- The Kroger Co. acquires (approval pending) Fred Meyer with a new combined volume of $43.1 billion.
- Albertsons acquires (approval pending) American Stores, Buttrey and Seessell's with a combined volume of $35.7 billion.
- Safeway acquires Carr Gottstein Foods and Dominicks for a combined volume of $26.5 billion.
- Ahold acquires Giant Food for a combined volume of $18.5 billion.
- SuperValu acquires Randall Stores and Tidyman's for a combined volume of $18 billion.

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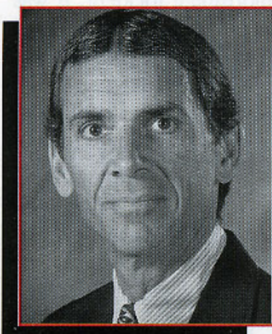

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What is one to make of all these new business combinations where, both in Canada and in the U.S., a small handful of retail food companies may control nearly 50 percent of all grocery sales? Are we approaching "monopolistic" type conditions (or more properly, "oligopolistic" type), where the few and powerful retailers will be able to raise prices to above competitive levels and to dictate the terms of trade to the detriment of suppliers and consumers both? Frankly, despite the hoopla in the press, the answer is: unlikely.

The situation in Europe provides an important perspective. For years the concentration of European retailers has been two to three times as dense as the situation in the U.S. The market share held by the top five retailers in a sample of European countries in the mid-1990s' is shown below:

- Finland 96.4%
- Sweden 80.8%
- Austria 70.2%
- Switzerland 65.0%
- Great Britain 64.0%
- Belgium 50.0%
- Germany 46.7%
- Netherlands 46.0%

Yes, by any conventional economist's standards, very concentrated markets. Yet any examination of the economic performance of the food system in this subset industrialized countries finds that conditions are generally healthy. A wide variety of suppliers of all sizes and structures exists, consumers have a considerable spectrum of choices among stores — often more extensive than in the U.S. on a market-by-market basis — and the food quality and innovation are arguably equal to or better than the U.S. standards. It is true that price paid for food in western Europe is, on average, slightly greater than in the U.S., but after adjusting for higher tax rates and certain governmental socialized programs in Europe, the differences are marginal.

Moreover, for years in the United States there has been a perception on the parts of many in the food industry that the pendulum of the so-called balance of power has swung in the direction of the retailers. This supposed shift has taken place presumably as a result of more consolidated retailers, who have more control of the levers of power (including especially the power of information) than at any time in the past. The implication of this (perceived) shift is that the rest of the food system, consumers and suppliers, will suffer as a consequence of more powerful retailers interested primarily in their own welfare.

While the factors to consider in such an evaluation are many and complex, an examination of the main factors produces a conclusion contrary to the conventional perceptions above. Limiting analysis to profits alone — perhaps the single most telling criterion of overall economic health — it can easily be shown that over the past five years (also true for the past 10 or 20) retailers have not been more profitable than manufacturers. If it were true that retailers had acquired all this additional power and control, wouldn't we expect that to be built into their profit structure? Similarly, wouldn't investors have by now caught on and invested more heavily in the sector that was to become so much more dominant, thereby bidding up the price of retailers' stocks? Yet again, indexes of retailer stocks show that, on average, they have gone up by less in recent years than manufacturer stocks.

The real winner of the changing structure of the U.S. food system has been consumers. They have more new product innovation, larger stores, more high quality food choices and, when adjusted for inflation, lower real prices than they paid 10 years ago. Not all of this can be attributed to retail consolidation, but it would be fair to conclude that some of the consequences of retail consolidation may be good news. DB