# Industry Structural Change

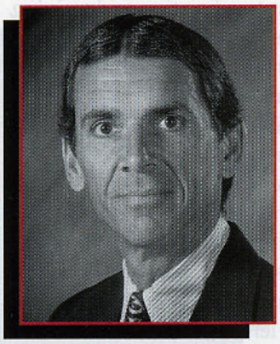
By Edward McLaughlin

It's pretty commonplace to talk about industry change: the players, the technology, the standard operating practices. It is the stuff of marketing plans and after-dinner speeches. But the biggest change of all is structural. The big are getting bigger—in company size, in technological scope, in geographic expansion and in assortment and options carried. An understanding of the major structural factors in a given industry is critical to executives, since business strategies must be consistent with the organizational structures that surround them. Indeed, a considerable body of research demonstrates that industry structure shapes strategies and general business practices, and the combination of the two is responsible for determining industry performance: employment, variety, sales and profits. Thus, it is of utmost interest for executives to be well informed of industry structural conditions and the changes taking place therein.

In the food industry, change is taking place especially rapidly. For one thing, few other industries are more directly consumer driven. Food retailers interact with shoppers everyday and hence have the opportunity to observe up close consumers' changing attitudes, preferences and shopping patterns. The successful retailers respond to these behaviors. In 1996, consumers spent $2.5 trillion dollars in U.S. retail establishments and, among the major divisions of retailing, the food business was Number One.

When considering all food stores sales together with foodservice establishments (eg., "eating and drinking places"), food sales accounted for 26.9 percent of all retail sales. The only other major industry even close to demonstrating its importance like food was automotive (24.6 percent of total retail sales). Bestowed with such prowess, it becomes easier to understand the serious concern for progressive change and efficiency that often focuses on the food industry; it has tremendous influence on the entire national economy.

Furthermore, the value-added portion of the food system is the portion reporting the most rapid growth. By this I refer to food manufacturing, wholesaling, retailing and foodservice. Consider the food system in its two major components: the farm production component and the marketing component — that is, everything past the farm gate. As recently as 1970, farmers took home approximately 32 percent of all consumer expenditures, while the marketing companies captured the rest (68 percent). In 1996, however, farmers only took home 23 percent of the so-called food dollar, down by over one-third in only a generation. In other words, food manufacturers, transportation companies, advertising agencies, retailers and others gained substantially on farmers' share. Now the latter account for 77 percent of all consumers' purchases. The reasons for this are complex but key to this trend is the ability of value-added food companies to meet the needs of quality, variety and additional convenience demanded by contemporary shoppers.



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**Food executives would be well-advised to keep abreast of industry structural conditions and changes.**

Perhaps the most dramatic among the various structural changes is the extent to which the food industry is becoming more concentrated. At the manufacturer, wholesaler and retailer level, mergers and acquisitions have proceeded at unprecedented levels over the last decade. Irrespective of the industry level, even including agricultural production, fewer and fewer firms today control a greater and greater portion of overall sales. Take the example of U.S. food retailing. The leaders are huge companies, and getting bigger.

In 1996, the top two companies together, Kroger and Safeway, registered nearly $50 billion in sales. The Top 10 companies as a group account for about 40 percent of all food sold in the U.S. but when measured regionally, over two-thirds of all food in most markets is sold by the top four retailers. Selected markets are even more concentrated: in Rochester, NY and Washington, D.C. over 75 percent of the market is controlled by two retailers only. Such concentration confers enormous power and influence to the retailers in these markets who effectively become the gatekeepers of the supermarket shelves. They control which products from manufacturers get through to consumers and how that variety will be priced. Wal-mart, the world's largest retailer, moved up to the third largest food retailer in the U.S. in 1996 with the sales from its supercenter format alone.

Significantly, today three of the Top 10 U.S. retailers are partly- or fully-owned by foreign companies: Ahold, A&P and Food Lion. Once believed to be a local business only, retailing has gone international in a big way. Already, a handful of huge players are dictating terms on virtually every continent from headquarters often thousands of miles away. The global leaders? Currently, and for the foreseeable future, they are: The Metro Group (Switzerland), Tengelmann (Germany), Aldi (Germany), Wal-mart (USA), Promodes (France) and Carrefour (France). Increasingly, it will be difficult for other companies to break into this core group.

These sweeping structural changes have and will continue to be the most important force shaping food business practices in the future. My advice? Stay closely tuned to survive. DB