New Relationships Between Retailers and Shippers: Trade Practices

Retailer-shipper agreements center on quantity and price considerations. Increasingly, however, retailer-shipper transactions include off-invoice marketing and trade practices. “Trade practices” cover both fees (such as volume discounts and slotting fees) and services (like automatic inventory replenishment, special packaging, and requirements for third-party food safety certification.) The term also refers to the overall structure of a transaction—for example, long-term relationships or contracts versus daily sales with no continuing commitment. The specific provisions of transactions between buyers and sellers are, by their nature, proprietary. Little public information is available, except for anecdotal information reported in trade publications.

There are differences in opinion about the growing use of fees and services in marketing produce. Shippers argue that mergers have given retailers market power over them, citing fees and services as evidence. These fees, they argue, undercut competition and reduce consumer welfare by reducing output, increasing prices, or slowing product innovation. Retailers counter that the explosion in new products exerts enormous pressure on a limited amount of shelf space, and fees serve to efficiently allocate that space. Thus, increases in fees reflect the increasing cost of retailing (Bloom et al., 2000).

To better understand trade practices, ERS and its cooperators conducted personal interviews with shippers, supermarket retailers, and wholesalers.[4] The interviews focused on the following products: California grapes, California oranges, Florida and California mature-green tomatoes, California vine-ripe tomatoes, Florida grapefruit, and California/Arizona lettuce (head, leaf, and romaine) and bagged salads. Shippers, retailers, and wholesalers answered questions about contracts, fees, marketing services, pricing, number of accounts, and length of accounts for the years 1994 and 1999.

Seventy-four personal interviews were conducted: 57 with shippers and 17 with retailers and wholesalers (table 2). Proportional random sampling was used to select the shippers interviewed, with medium and large firms given more weight in the sample selection process than small. (Small shippers sell very little to retailers, the focus of the study.) Retailers (supermarkets) and wholesalers were both large and midsized, and covered different regions.

Interview results suggest that the structure of the shipping industry varies greatly according to product. For example, in 1999 there were 149 California grape shippers, with none accounting for over 6 percent of total industry sales. At the other extreme, there were only 25 California tomato shippers, down from 31 in 1996. While there were 54 bagged salad firms selling to retailers (down from 63 in 1994), the top two firms accounted for 76 percent of total fresh-cut salad sales in supermarkets. Hence, for a few fresh produce items, concentration of sales at the shipper level has surpassed that of retailers, even though the sales of these firms may still be small relative to those of the large retail chains.

The wave of retail consolidation in the late 1990s raised the question of whether newly formed companies were merging their buying operations. If they were, shippers might have fewer supermarket customers since each buyer would be purchasing for a larger number of stores, which might increase the negotiating power of buyers relative to shippers.

When asked about the number of customers (supermarket, foodservice, and mass merchandisers), shippers reported small changes in the number of regular customers. Although some shippers reported a decrease in the total number of customers, roughly as many reported an increase. Some shippers were selling to fewer but larger retail accounts, and others were replacing retail accounts with other types, such as foodservice buyers.

Supermarket retailers report similar findings: between 1994 and 1999, retailers reported that the number of their produce buyers remained fairly constant at the corporate and division levels, although 18 percent reported a decline in field buyers. The ultimate impact on shippers of fewer supermarket field buyers is likely offset by the increase in purchases by foodservice buyers and mass merchandisers.

Although the total number of produce buyers of all types may not have changed much for most shippers between 1994 and 1999, the importance of the largest buyers has increased (table 3). The top four buyers accounted for 22 to 45 percent of sales in 1999, depending on the product. The largest increase (11

[4]Results from these interviews are reported in greater depth in Calvin et al.

Table 2—Number of firms interviewed, total number of shippers, and share of State production

Type of firm	Firms interviewed	Shippers in State	Share of 1999 State production[1]
	Number		*Percent*
Shippers			
California fresh grape	9	149	19
California orange	9	39	38
Florida grapefruit	8	110	54
California tomato	8	25	56
California tomato (repackers)	2	n.a.	n.a.
Florida tomato	6	65	32
California/Arizona lettuce[2]	8	n.a.	n.a.
California/Arizona bagged salad[3]	7	54	n.a.
Retailers and wholesalers			
National retailers	8	n.a.	n.a.
Regional retailers	6	n.a.	n.a.
Wholesalers	3	n.a.	n.a.

Notes: n.a.= Not available or not applicable.
[1]Imports and production from other States handled by these shippers were excluded in determining the sample share of State production.
[2]Lettuce includes head, leaf, and romaine.
[3]Number of firms selling bagged salads nationally to mainstream supermarkets is used as a proxy for the number of California/Arizona shippers.
Sources: Calvin et al., 2001.

Table 3—Share of total shipper sales going to top 4 and top 10 buyers, 1994 and 1999[1]

	California grapes	California oranges	Florida grapefruit	California tomatoes	Florida tomatoes	CA&AZ lettuce
Top 4 buyers:			*Percent of sales*			
1994	29	28	26	26	34	21
1999	31	34	29	28	45	22
Top 10 buyers:						
1994	47	46	54	45	48	37
1999	49	52	51	48	59	39

[1]Results are based on a limited number of observations and must be interpreted with caution.
Source: Economic Research Service, Produce Marketing Study interviews, 1999-2000.

percent) in this share was for Florida tomato shippers. Retail buyers, on the other hand, reported their top four suppliers provided from 85 to 97 percent of total purchases, depending on the product, in 1999 (fig. 6).

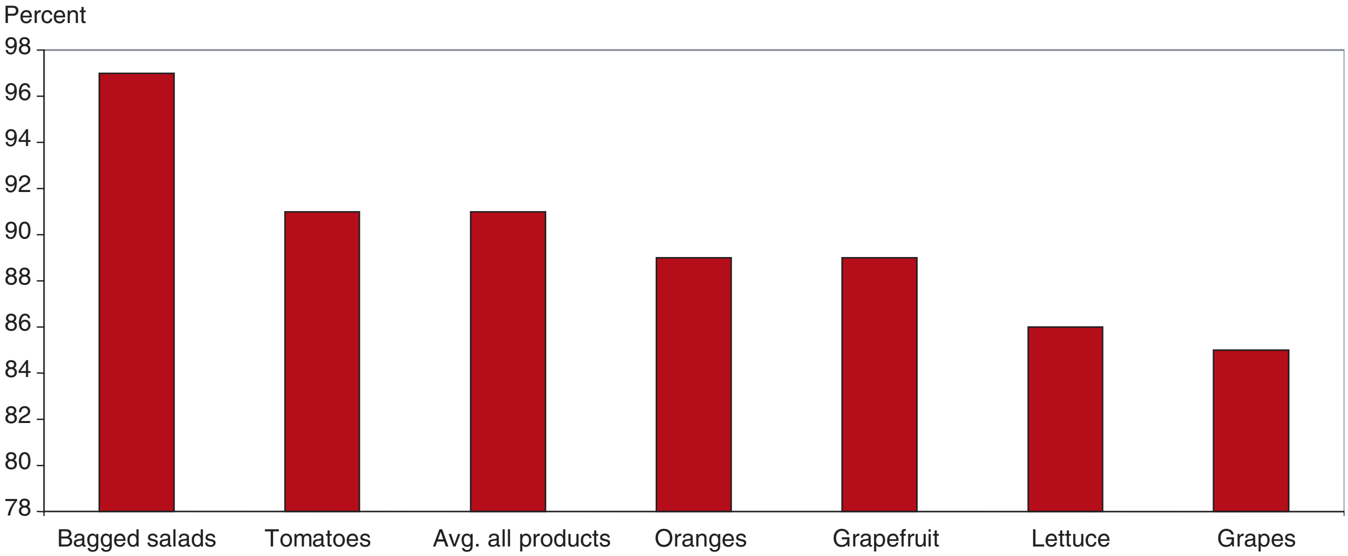
Nonprice Provisions

Traditionally, the fresh produce industry has been characterized by daily sales transactions. For grapes, oranges, grapefruit, and tomatoes, daily sales remain the most important sales mechanism across all types of buyers. However, the share of daily transactions to total transactions declined from 72 percent in 1994 to 58 percent in 1999. The use of advance pricing arrangements for promotions increased from 19 to 24 percent over the same time period, and the number of weeks in advance for which prices are fixed appears to have grown as well.

The use of contracts has also become more common. In 1999, short-term contracts accounted for 11 percent of total commodity sales (grapes, oranges, grapefruit, and tomatoes), and long-term (annual or multiyear) contracts 7 percent. Lettuce sales mechanisms in 1999 were similar to those of other commodities, except that all contracts were long term. Bagged salad shippers indicated that annual or multiyear contracts are the standard for retail sales.

Since the inception of supermarkets when retailers requested free samples of products, nonprice provisions have been part of the retailer-shipper transaction. Since then, new kinds of provisions have been intro-

Figure 6
Share of produce purchased by retailers from their top four suppliers in 1999



Source: Economic Research Service, Produce Marketing Study interviews, 1999-2000.

duced. Shipper and retailer interviews provided insight into the frequency and magnitudes of the provisions. Most shippers and retailers reported that the incidence and magnitude of fees and services associated with transactions had increased between 1994 and 1999. Fees paid to retailers are usually around 1 percent of sales for grapes, oranges, grapefruit, and tomatoes, and range from 1 to 8 percent for bagged salads. Overall, 48 percent of the types of fees requested were new in the last 5 years (1994-99).

Forty-one percent of firms reported they had lost accounts when they did not comply with a fee request from retail or mass-merchandise buyers. The most frequently paid type of fee is the volume discount, a trade practice that has been used for years, although shippers agree that the incidence and magnitude of this fee has increased. Volume incentives can promote a more stable relationship between suppliers and retailers; as the retailer buys more units from the supplier, costs per unit decline, providing an incentive for the retailer to buy larger quantities (over the season) from a particular supplier. Shippers and retailers may both gain efficiencies in marketing by increasing the size of accounts.

Slotting fees have long been used in the supermarket for dry grocery items, and recently entered the fresh produce department. Slotting fees are common for fresh-cut produce and may be either requested by retailers or offered by shippers. Bagged-salad shippers reported that shippers, not retailers, first introduced slotting fees to this industry in an attempt to buy market share from their competition; they also reported that the fees began before the last wave of retail consolidation. Slotting fees were reported to 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. None of the grape, orange, grapefruit, and tomato shippers reported paying slotting fees as defined in our study.

Requests for marketing services from produce shippers have increased, with 77 percent of requests reported as new between 1994 and 1999 (see box “Select Services Requested”). Overall, shippers reported having lost 21 percent of accounts for noncompliance with a service request. Shippers believe they receive more benefits from providing services than from paying fees, as they may obtain advantages relative to competitors. This likely explains their higher compliance with services than fees. According to shippers, the most common service requested is third-party food safety certification, followed by returnable plastic containers.

Retailer interviews indicate that 9 out of 10 retailers requested more services from their suppliers in 1999 than in 1994. On average, retailers report requesting 5.5 different services from suppliers. The top three ser-

Select Services Requested

Third-party food certification. Third-party food certifiers examine suppliers for compliance with microbial quality control processes, pesticide application, and pesticide residue regulations.

Returnable containers/pallets. Recyclable plastic cartons and standardized pallets may help to streamline handling at the distribution and retail levels.

Electronic data interchange. Electronic interchanges between specific retailers and their preferred suppliers are used for invoicing, electronic ordering, and other procurement activities.

Provision of private labels. Private-label products (also known as "house brands") bear the name of the retail outlet where they are sold (such as Safeway or Stop & Shop). Suppliers and retailers can lower costs and increase gross margins by selling private-label products.

Automatic inventory replenishment. The supplier is electronically integrated into the buyer's inventory management system. The preferred supplier has responsibility for and access to the data necessary to co-manage the inventory with the retailer.

Category management. Retailers who use category management (merchandising of product groupings based on actual consumer purchasing patterns) analyze detailed sales data to create an optimal product mix, usually with the help of a manufacturer from within that category.

vices requested (as reported by retailers) are private-label produce items, category management, and electronic data interchange. More than half of retailers asked for special transportation arrangements (such as discounts on transportation for large volume sales), new types of packaging, and third-party food safety certification.

Interviews with shippers and retailers indicate that their relationship is changing. But are increased fees and services the result of retailer market power over shippers? Or has the trading relationship changed because of increased consumer demand, technological innovations in marketing/retailing fresh produce, and growth in foodservice firms and mass merchandisers? An important first step in addressing these questions is to examine retailer pricing behavior.