Chapter 2. The Marketing System

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Special Topic – The Economy's Effect on Marketing and Promotion

One of the most important system issues is the economy. Banking, stock market, and fuel prices have sent shocks into all sectors, including food. Food price increases hit year-ago rates of 8-8.5% at times during 2008, and fuel costs are still high, although they continue to drop. As a matter of fact, after a year of higher than usual inflation, economists are now watching for signs of deflation.

The Department of Commerce's *Monthly Retail Trade and Food Service Sales* figures indicate that, during the month of September 2008, retail sales were down 0.3% from a year ago, September 2007 (Figure 2 – 1). Because people still need to eat, however, food retailers are doing better than the average retailer. Supermarket sales were up 3.7% and Warehouse Clubs and Supercenters (for example Costco and Walmart) were up 5.9%. Interestingly enough Beer, Wine, and Liquor store sales were up 5.6% and Drinking Establishment sales were up 7.4%.

Shoppers themselves are interested in self preservation and in downsizing their purchasing. They are shopping discount stores and extreme discount stores (Aldi and Walmart are doing very well, thank you); some are using one-stop shopping to conserve fuel, others are shopping the deals. Many consumers are eschewing premium brands for private label; many are using coupons at a level unseen in years. And, for the first time in decades, consumers are increasingly brown bagging lunch and fixing meals at home, as restaurant sales have plummeted.

Almost 40 years ago, the situation was similar. There was rampant inflation – food in the 70s *averaged* 8.1% inflation (see table below) – fuel was rationed, and there were lines at the gas pumps.

FOOD PRICE INFLATION

Decades	Average annual percent change by decade
1970s	8.1%
1980s	4.6
1990s	2.8
2000s	2.7
2007	4.2
2008 est.	5.0 – 6.0

Source: Food Marketing Institute Speaks report, 2008 and USDA-ERS, Food CPI, Prices, and Expenditures, http://www.ers.usda.gov/Briefing/CPIFoodAndExpenditures/Data/cpiforecasts.htm

One of the results of the 70s? Generics in the black and white box and the further development of private labels.

Picture: Wikipedia, http://en.wikipedia.org/wiki/Generic_brand

TABLE 2 – 1. MONTHLY RETAIL AND FOOD SERVICE SALES, PERCENT CHANGE FROM YEAR AGO

Kind of Retail Business	September 2008 sales – % change from year ago
Retail sales, total	-0.3%
Automobile dealers	-23.5
Building mat. and supplies dealers	-0.3
Supermarkets and other grocery (except convenience) stores	3.7
Beer, wine, and liquor stores	5.6
Pharmacies and drug stores	6.1
Gasoline stations	14.9
Clothing stores	-5.2
Hobby, toy, and game stores	5.0
Department stores(excl. discount department stores)	-14.3
Warehouse clubs and superstores	5.9
Used merchandise stores	9.7
Electronic shopping and mail-order houses	8.5
Food services and drinking places	2.7
Drinking places	7.4

Source: US Department of Commerce, Census Bureau. *Monthly Retail Trade and Food Service Survey*, September 2008. http://www.census.gov/mrts/www/mrts.html

What can marketers in this environment do? Discount retailers are doing extremely well in these economic times. They already have streamlined supply chains, no-frills stores and are often EDLP (every day low price). Higher-end retailers, however, may not want to sacrifice their image of quality and service to start deep price wars, as shoppers become easily hooked on price discounts. For example, AC Nielsen reported that just over 35% of all product sales from food/drug/mass from July 2007-July2008 were on promotion (The Nielsen Company, *Trade Promotions in the US,* September 2008).

Displays and in-store advertising, ads in flyers, and shelf positioning. These merchandising tactics can increase volume without sacrificing price. As a matter of fact, Nielsen also reported that features (ads in flyers, papers, in-store) generate a greater lift in sales (an added 87%) than do displays (an added 78%) or price reductions (and added 44%) (The Nielsen Company, *Trade Promotions in the US*, September 2008). In addition, retailers and suppliers should strategically promote items which appeal to the economizing shopper. Using up ad space to feature filet mignon may not make as much sense as using it for boneless breast of chicken.

Those with established private labels can and are supporting them prominently. Supporting their own private labels can help their margins and also help satisfy their customers who are looking for those ways to economize and interested in trading down from the more expensive national brand to the less expensive private label.

Coupons, traditionally used by brand manufacturers, are being clipped, sorted, and used by consumers. Coupons can provide a double benefit. They can provide sales incentive for the consumer looking for a deal or way to economize. They can also provide inexpensive, visible, print advertising for the manufacturer.

Differentiated promotions with targeted value may be especially appealing. Promotions tied to local organizations or charities—say, the local food banks—may attract consumers. Recently, a national jeweler offered a $25 off coupon to anyone who brought in a can of food for the local food pantry. A genuine offer that targets the holiday shopper.

The impact on consumers cannot be denied. Already, consumers have increased their savings rates, something unheard of in the US in decades. Some have suggested that some shopping behavior changes—increased use of private label, shopping deep discount stores—could become permanent in our society. And the importance of the value in the cost/benefit ratio will be under the microscope as people adjust.

The U.S. Food Marketing System Update

2008 may have seen the greatest food inflation in recent decades. While the repercussions of high fuel prices and high commodity prices are still being felt by some industries, food inflation, in general, is slowing down. The Economic Research Service at the USDA is forecasting 4 – 5% inflation for food in 2009, down from the estimate of 5 – 6% for 2008 (Figure 2 – 2).

TABLE 2 – 2. CHANGES IN FOOD PRICES, 2005 THROUGH 2009

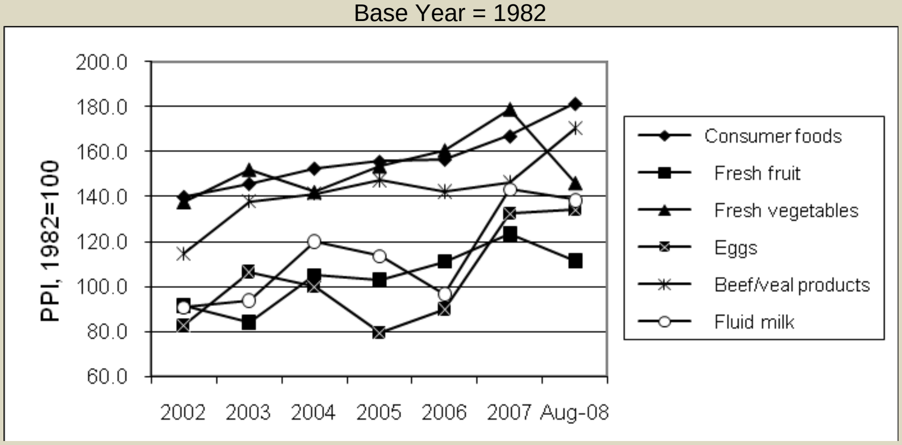
	2005	**2006**	**2007**	**Forecast 2008**	**Forecast 2009**
	% change				
All food	2.4	2.4	4.0	5.0 to 6.0	4.0 to 5.0
Food away from home	3.1	3.1	3.6	3.5 to 4.5	4.0 to 5.0
Food at home	1.9	1.7	4.2	5.5 to 6.5	4.0 to 5.0
Beef and veal	2.6	0.8	4.4	3.0 to 4.0	6.0 to 7.0
Pork	2.0	-0.2	2.0	1.5 to 2.5	5.0 to 6.0
Other meats	2.4	1.8	2.3	1.0 to 2.0	2.5 to 3.5
Poultry	2.0	-1.8	5.2	4.0 to 5.0	5.0 to 6.0
Fish and seafood	3.0	4.7	4.6	5.5 to 6.5	4.0 to 5.0
Eggs	-13.7	4.9	29.2	13.5 to 14.5	1.0 to 2.0
Dairy products	1.2	-0.6	7.4	8.0 to 9.0	4.0 to 5.0
Fats and oils	-0.1	0.2	2.9	13.0 to 14.0	3.0 to 4.0
Fresh fruits	3.7	6.0	4.5	6.0 to 7.0	4.0 to 5.0
Fresh vegetables	4.0	4.6	3.2	6.0 to 7.0	3.5 to 4.5
Processed fruits and vegetables	3.3	2.9	3.6	8.5 to 9.5	3.0 to 4.0
Sugar and sweets	1.2	3.8	3.1	4.5 to 5.5	3.0 to 4.0
Cereals and bakery products	1.5	1.8	4.4	9.0 to 10.0	3.5 to 4.5
Nonalcoholic beverages	2.9	2.0	4.1	3.5 to 4.5	3.0 to 4.0

Source: USDA-ERS, Food CPI, Prices, and Expenditures, http://www.ers.usda.gov/Briefing/CPIFoodAndExpenditures/Data/cpiforecasts.htm

The Producer Price Index

The Producer Price Index (PPI), unlike the CPI, is based on prices received by producers from first point of sale. This index is based off the year 1982. For example, a PPI of 100.0 reflects a farm price equal to that of the base year, 1982. For many years the PPIs, including that for all consumer foods, have all hovered between roughly 80 – 160%, a testimony perhaps to the great output and efficiencies of the agricultural system but also to the downward price pressures put on the system. Starting in 2006 and continuing sharply in 2008, increases in fuel prices and in corn and wheat prices drove up the costs and prices of many commodities.

PRODUCER PRICE INDICES, FARM PRODUCTS
Base Year = 1982



Source: USDA-ERS, Agricultural Outlook http://www.ers.usda.gov/publications/Agoutlook/AOTables/ last updated October 2008.

For several years, consumers have been decreasing their beef consumption and increasing their consumption of chicken (Table 2 – 3). As a matter of fact, as consumers economize, they continue this "trade down". Chicken consumption continues to increase, beef consumption continues to slide. Pork, the other white meat, appears to be holding its own.

Consumers continue their love affair with cheeses and yogurts. Cheese consumption has increased from roughly 27 pounds per capita in 1996 to 32 pounds per capita in 2006. Yogurt consumption has climbed from almost 6 to 11 pounds per capita. Fluid milk consumption, however, continues to drop, even skim milk. Skim milk consumption fell from almost 33 to 28 pounds per capita.

Fresh fruit consumption has increased marginally (although processed consumption continues to drop more quickly than the increase in fresh consumption) from 126 to 129 pounds per capita in the same time period. Fresh vegetables have increased quite nicely from 186 to 196 pounds per capita, although it has not increased since 2001.

Consumption of fresh commodities is more difficult to track over time as consumption in individual years is greatly affected by commodity prices.

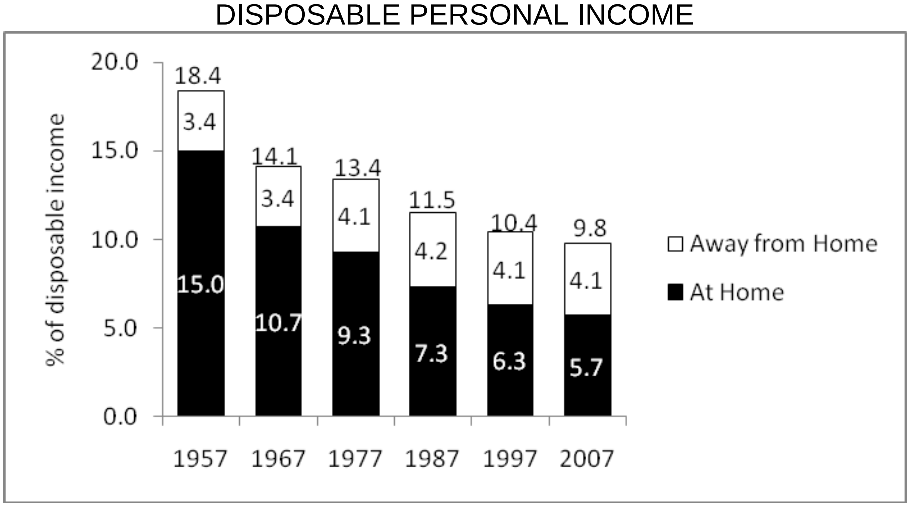
TABLE 2 – 3. PER CAPITA CONSUMPTION OF SELECTED FOOD COMMODITIES

	1996	2001	2006
		Lbs.	
Beef	64.0	63.1	62.7
Pork	45.2	46.9	46.0
Chicken	48.8	54.0	61.4
Eggs	30.1	32.5	32.4
Dairy products			
Cheese (excluding cottage)	27.3	30.0	32.4
Fluid skim milk	32.9	28.8	27.8
Yogurt (excluding frozen)	5.9	7.0	11.0
Salad and cooking oils	25.7	35.5	44.4
Fresh fruits	126.3	125.8	129.1
Fresh vegetables	186.3	196.2	196.0
Coffee (green bean equiv.)	8.7	9.5	9.5
Cocoa (chocolate liquor equiv.)	4.2	4.5	5.2

Source: USDA-ERS, Agricultural Outlook: Statistical Indicators, Food Supply and Use, Table 39. http://www.ers.usda.gov/Publications/AgOutlook/AOTables/

Despite this year's price increases, food expenditures as a percent of disposable income remain steady. Fifty years ago, families and individuals spent 18% of their disposable income on food, while in 2007, food cost only 9.8% of our disposable income (Figure 2 – 1).

FIGURE 2 – 1. FOOD EXPENDITURES AS A SHARE OF DISPOSABLE PERSONAL INCOME



Source: USDA-ERS, Food CPI, Prices and Expenditures.
http://www.ers.usda.gov/Briefing/CPIFoodAndExpenditures/Data/table7.htm

Food and beverage sales experienced very good growth in 2007, increasing 5.4% from 2006 (Table 2 – 4). Food away from home sales increases (5.0%) backed off of the strong growth seen in the last 5 years. For the first time in the last 6-7 years, food at home sales growth out-paced food away from home.

TABLE 2 – 4. FOOD SALES[1]

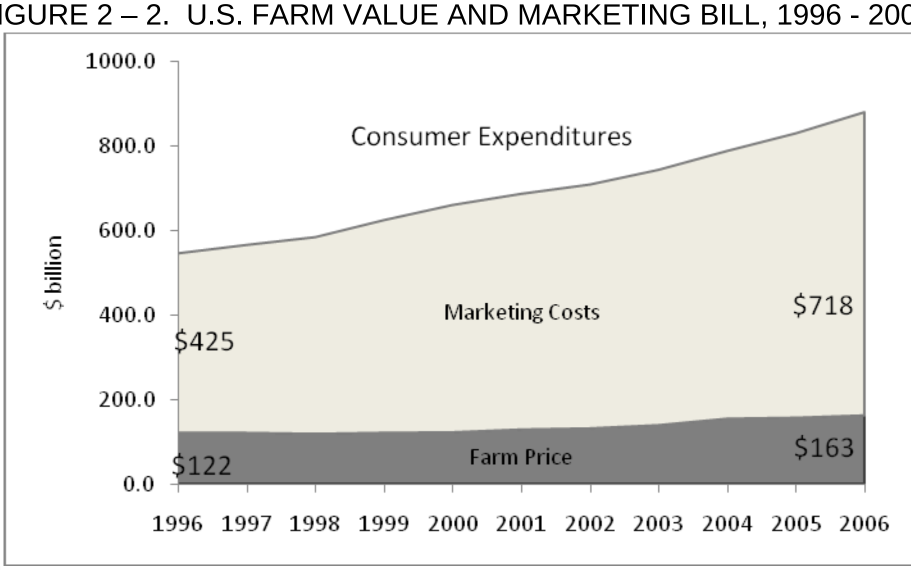
Sector	Sales 2006	Sales 2007	Increase	Growth
	--$ billion--		--$ billion--	--% change--
Total food and beverage sales	1,186,402	1,250,224	63,822	5.4%
Total food sales (excluding alcohol)	1,032,325	1,087,685	55,360	5.4%
Food at home sales	545,839	577,002	31,163	5.7%
Food away from home sales	486,486	510,683	24,197	5.0%
Alcoholic beverage sales	154,077	162,539	8,462	5.5%

[1] Sales only. Does not include home production, donation, or school lunch program expenditures
Source: USDA-ERS, http://www.ers.usda.gov/briefing/CPIFoodAndExpenditures/Data/table1.htm.

The USDA calculates farm price or value and marketing costs for food produced and consumed in the United States. In 2006, the latest year with data, consumer expenditures for food produced in the U.S. totaled $881 billion (Figure 2 – 2). Of that, the farm value portion was $163 or 19% of expenditures.

Of the $881 estimated expenditures for food produced and consumed in the U.S., $718 or 81% are estimated to be for marketing costs.

FIGURE 2 – 2. U.S. FARM VALUE AND MARKETING BILL, 1996 - 2006[1]



[1] Marketing bill and farm value components of consumer expenditures for domestically produced farm foods
Source: USDA-ERS Food Marketing and Price Spreads,
http://www.ers.usda.gov/Data/FarmToConsumer/marketingbill.htm (updated November 2008).

The term "marketing" costs is a bit misleading to some. Marketing costs include much more than advertising and promotion costs, which are only a small fraction of the marketing costs. Marketing costs include packing, shipping, and processing post farm gate, such as all food processing and manufacturing, as well as distribution from production areas to the larger markets. The increasing portion of marketing costs is a reflection of the greater transformation of farm products to consumer ready-to-eat products. In addition, marketing costs associated with food away from home expenditures are greater than retail costs as they include chef preparation and restaurant overhead costs. And as consumers eat out more, these costs constitute a greater portion of the marketing bill.

Estimates of the components of the marketing bill from 1970 – 2006 are shown in Table 2 – 5. Since 1970, an increasing proportion of the "marketing bill" has been spent on labor. Packaging material costs have fluctuated somewhat. It is interesting to note the portion spent on shipping and energy since 1970. Each, in general, is not a large share of the marketing bill, and even combined, they represent less than 10% of marketing costs. Since 1980, in the period of the last energy "crisis", energy costs as a portion of the total bill have dropped. Only recently has this increased. Recent surges in energy prices in 2007, however, are currently being felt in transportation, distribution, and manufacturing. Data for 2007 are not available at this time.

FIGURE 2 – 4. MARKETING BILL COMPONENTS FOR FOOD PRODUCED IN THE U.S., 1970 – 2006

Year	Labor[1]	Packaging materials	Intercity rail and truck transportation	Fuels and electricity	Corporate profits before taxes	Misc.[2]
			% of marketing bill			
1970	42.9	10.9	6.9	2.9	4.8	31.6
1980	44.6	11.5	7.1	4.9	5.4	26.4
1990	44.8	10.6	5.8	4.4	3.8	30.5
2000	47.0	9.9	4.9	4.3	5.8	28.0
2001	47.3	9.9	4.9	4.3	5.7	27.8
2002	47.3	9.8	4.9	4.3	5.7	27.9
2003	47.3	9.9	4.9	4.3	5.7	27.8
2004	47.9	10.0	5.0	4.4	5.6	27.1
2005	47.5	9.9	4.9	4.7	5.6	27.4
2006	47.5	9.8	4.9	4.7	5.5	27.5

"Other" includes depreciation, rent, advertising and promotion, interest, taxes, licenses, insurance, professional services, local for-hire transportation, food service in schools, colleges, hospitals, and other institutions, and miscellaneous items

The marketing bill is the difference between the farm value and consumer expenditures and covers processing, wholesaling, transportation, retailing costs, and profits.

Source: USDA-ERS, Food Marketing and Price Spreads, http://www.ers.usda.gov/Briefing/FoodPriceSpreads/bill/table2.htm (updated November 2008)