Chapter 2. The Marketing System

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Special Topic – The Year 2022

A panel was recently convened to describe the state of the food system in the year 2022. The panelists were part of the Produce Marketing Association's large annual convention and trade show held in October 2012 in Anaheim, California. Each panelist represented a different segment of the industry and each brought their business expertise to bear on the task. Each selected an important current trend and extrapolated out to the future ten years from now. But each selected different trends for different reasons, some as a word of caution, some as a word of hope. Panelists included:

Leslie Sarasin, president and CEO of the Food Marketing Institute
Vernon Crowder, senior vice president and agricultural economist at Rabobank's Research Advisory Group
Vic Smith, CEO and owner of JV Farms, Agricola El Toro, and Skyview Cooling Co.
Elliot Grant, founder of HarvestMark

In 2022, **Sarasin** indicated, more consumers label themselves as value seekers and the "attitude of frugality has become the norm." It will be entrenched as a part of our shopping behavior. Consumers will be using digital technology to shop smarter. Some of the results of this technology will be that "rather than modeling websites to reflect (bricks and mortar) stores, stores will be modeled to reflect smartphones." This will increase value to the consumer. There will be more e-commerce than ever, which will increasingly include food, and consumers "will be perfectly happy to have someone else select our tomatoes for us". There will also be an increase in smaller format stores that will each focus on one consumer value, shopping convenience, price, or assortment.

Crowder's tone was more cautious. He predicted that in 2022 the world's capacity to produce will be outstripped by the demands of the world's 7.9 to 8.0 billion people, "It certainly appears that our capacity to produce is not keeping pace with overall demand." One-half of the population will live in urban areas, and most urban development will be occurring in developing countries. The urban development will result in higher incomes, demand for more services, demand for more refrigerators, and greater meat consumption. Even though the population will grow by only one billion, Crowder expects food demand to double because people will be demanding higher quality foods resulting in a proportionally greater increase in production to meet this demand.

By 2022, the food supply will be much more volatile. After a long period of declining real food prices and subsequent research and development, productivity increases will be unable to keep up. The leading resource issues in 2022 in order of importance will be labor, water, energy, and land. Increases in yields will be needed, and to do so the industry will need GMOs (genetically modified organisms).

"The tables have turned," **Smith** said. "Our children now make us eat our vegetables. If we don't, they refuse to program our iPhone 10s or show us how to use our new driverless cars." As a reflection of how industry and policy have worked together on the health care crises, Smith predicted he would be better health, have lost 10 pounds, and would run a half marathon in 2.5 hours, a glowing prediction of how policies to increase fresh fruit and vegetable consumption will change life styles, primarily diets. Smith also predicted that the Food and Drug Administration and the industry would be aligned to approve food safety measures.

After solving the health care issues, the new focus in 2022 will be on food productivity and to grow more with fewer resources.

The last panelist, **Grant**, described how technology and the Millennial segment of consumers will drive the biggest changes in retailing. In 2022, the consumer will get a smartphone message about which store has the freshest salad in the area. And when they walk in the door of the store, they will get a message that new pineapples with the taste profile that they prefer are just in from Cuba. LEDs will be used to grow produce indoors in urban areas; algorithms using weather, markets, and price will be used by growers to hit optimum markets; and robots will be used to plant, pack, pick and ship product. And, "Every technology I just talked about in 2022 is actually available today in 2012," he said. "It's already being used by folks in this audience on a small scale." What will happen, he said, will be to move it to best use in 2022.

In response to an audience member's question, "What do we do to prepare for 2022," the panelists each provided their conclusion.

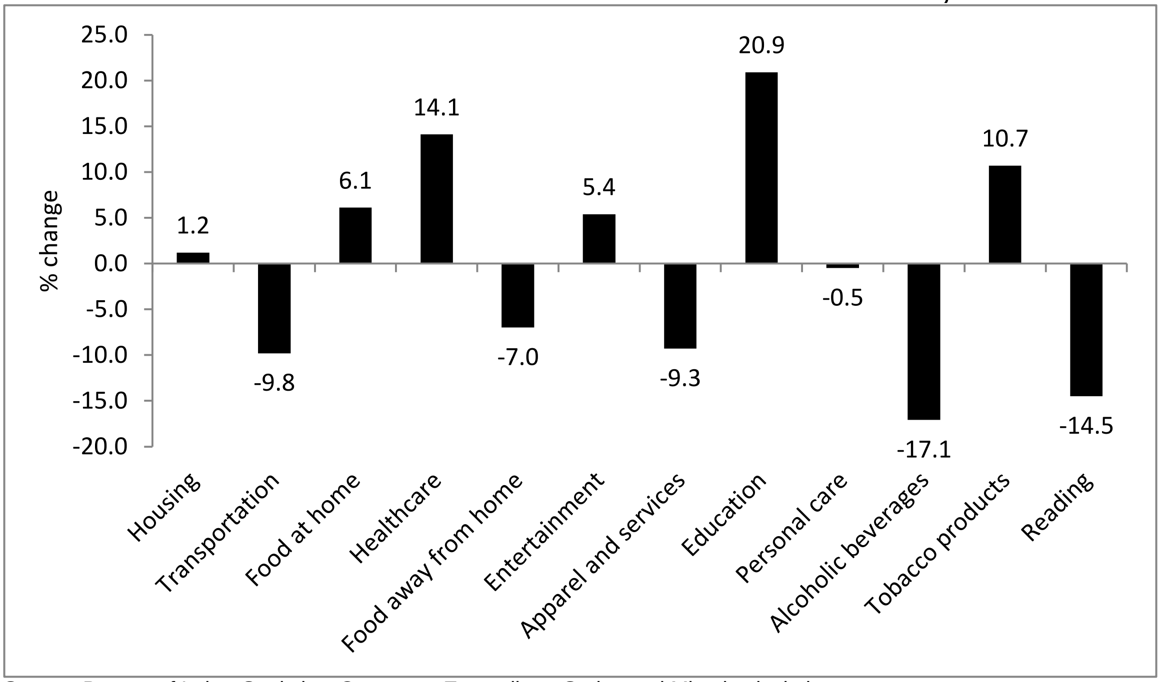
- Be prepared.
- Remember the strength of markets; markets work best when transparent.
- Engage in the community, policy, industry, and regulators.
- Be courageous and suspend disbelief.

The Value Shopper

The value shopper, the thrifty shopper, the frugal shopper. Five years after the start of the recession, the economy and industry members are still adjusting to changes in consumers' purchasing habits. As well they should. According to the U.S. Census Bureau, the real median household income in 2011 was 8.1% LOWER than in 2007, the year before the 2008 economic crash. In addition, the income inequality as measured by various indexes increased, and the top one-fifth of earners earned 51.1% of the income.

Overall, consumers have tried to juggle declining income against increasing costs of living. Consumers have increased their expenditures for housing, insurance, and healthcare, and adjusted by decreased spending in more discretionary items, such as food away from home, apparel and services, and personal care. Shifts in some expenditure categories are likely meant to decrease overall spending, such as the increase in food at home spending to offset the decrease in food away from home spending (Figure 2 – 1). Education expenditures increased significantly. In part this may be due to large increases in college tuition. In addition, it might also be due to delayed entry into the work force. As students graduate from college and are unable to find jobs, some may choose to delay their entry into the work force and attend graduate school. This tactic has been used by students in other recessionary periods.

FIGURE 2 – 1. PERCENT CHANGE IN CONSUMER EXPENDITURES, 2006 TO 2010



Source: Bureau of Labor Statistics, Consumer Expenditure Series and Mintel calculations.

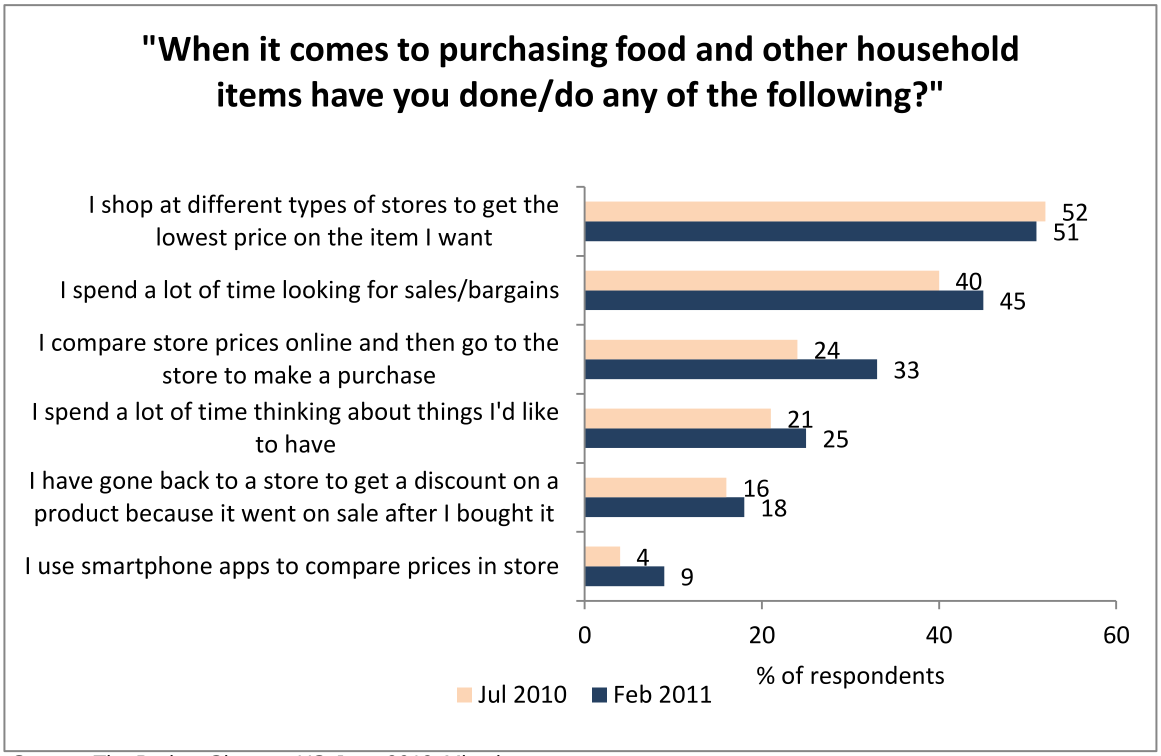
The recession increased consumers' quests for value and bargains. Behaviors such as budget shopping, making lists, using coupons, shopping sales, and even doing without have been used, are still being used, to make do with often lower incomes. According to Symphony IRI, consumers report that in 2011 they "cook more from scratch or with fewer convenience foods to save money" (47% of respondents) and are "eating out less often" (55% of respondents).

Budget shopping is becoming more involved and even becoming an art form to some. It involves more than the sales purchases and embraces multiple strategies to get the best price. In other words, consumers are out to maximize the value of their dollars, whether it's for entry-level products or for higher-priced brands.

Mintel Intelligence reports that between July 2010 and February 2012 consumers "shopped different types of stores to get the lowest price" at roughly the same rate (Figure 2 – 2). The number of consumers who "spend time looking for sales/bargains" increased slightly from 40% to 45%. The action that showed the greatest change was to "compare store prices online and then go to the store to make a purchase" up from 24% of consumers to 33%. It may be a reflection of the greater number of smartphones in the hands of the masses along with the number of stores putting out apps on these devices. In addition, there are online websites that search out lowest store prices.

Another budgeting behavior that is worth noting is the increase in consumers who "use smartphone apps to compare prices in store", up from 4% to 9% in February 2012.

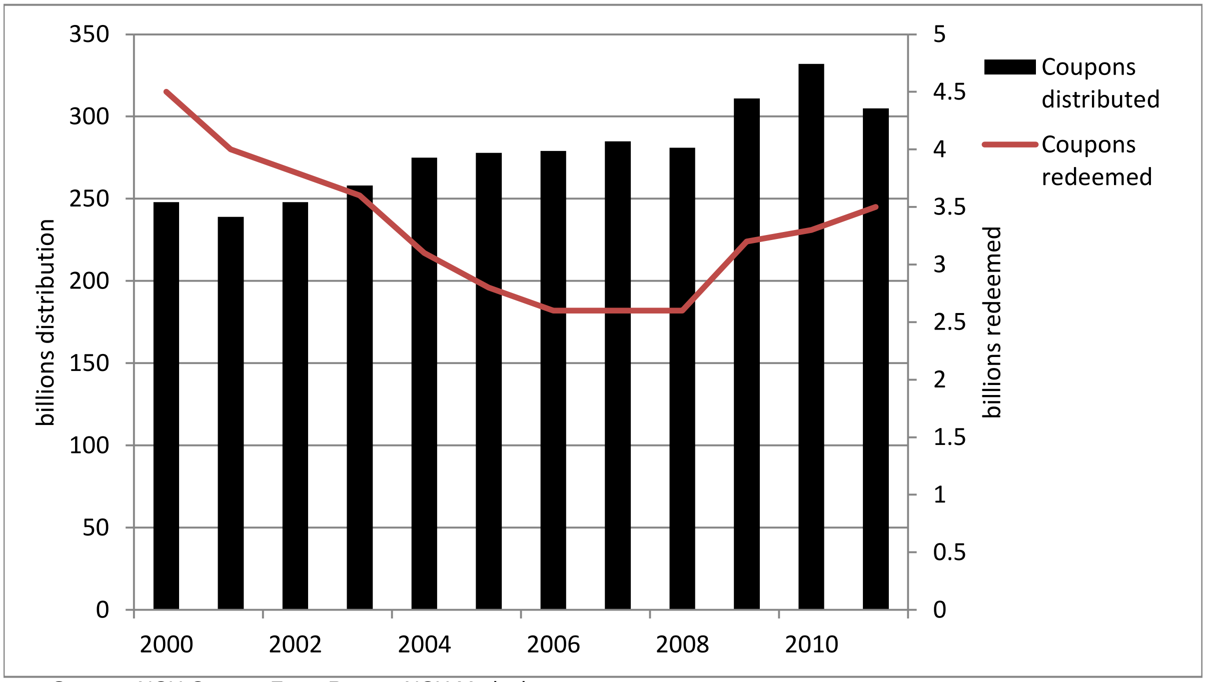
FIGURE 2 – 2. SHOPPING BUDGETING BEHAVIOR, FOOD AND HOUSEHOLD ITEMS JULY 2010 vs. FEBRUARY 2012



Source: *The Budget Shopper-US-June 2012*, Mintel

Coupons: For years, shoppers have saved money on name brands by clipping coupons. The number of coupons redeemed by consumers peaked in the late 1980s and early 1990s, but redemptions steadily declined since then until 2009, the year after the recession hit. For the last 3 years, redemptions increased (Figure 2 – 3). Manufacturers used coupons to boost interest and sales and attract customers to new products, while consumers increasingly used coupons to save money on the brands they wanted to buy. However, in early 2012 some brands offered fewer and less attractive face values and less time available to use the coupons, thereby, decreasing the number of redemptions.

FIGURE 2 – 3. COUPON DISTRIBUTION AND REDEMPTION

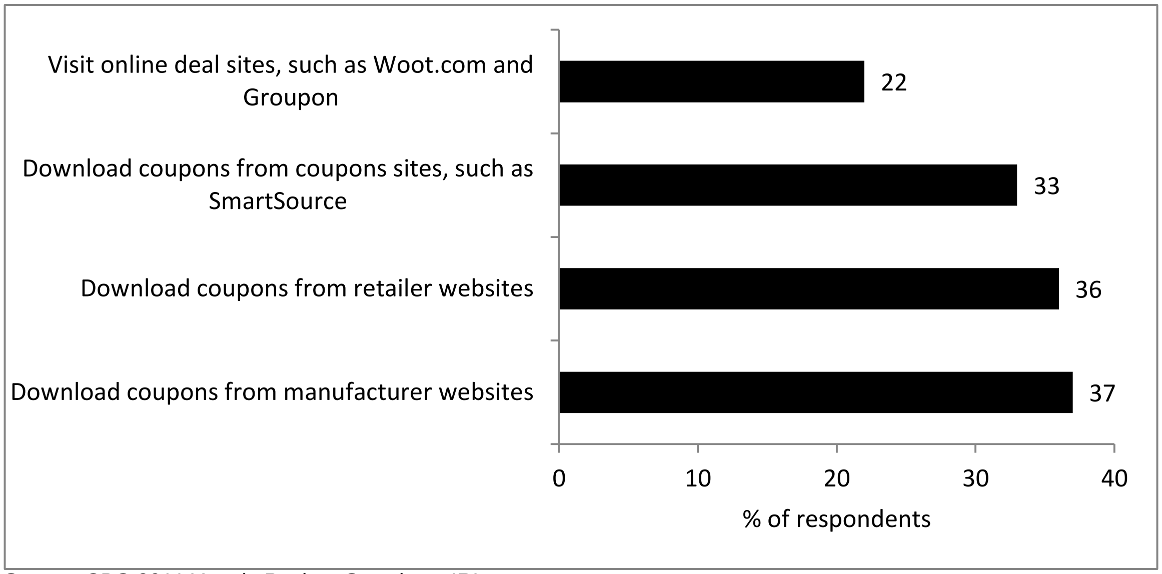


Source: NCH Coupon Facts Report, NCH Marketing.

What may boost interest in coupons are the availability now of coupons on the web. E-coupons can be found on manufacturers' sites, retailers' sites, coupon aggregation sites, and e-deals sites (Figure 2 – 4). Manufacturers' and retailers' sites are the most popular, used by more than one-third of shoppers. Interestingly, one-third of shoppers download coupons from couponing sites. Even new, budget-saving business concepts, such as Groupon, are accessed by almost a quarter of shoppers.

What will be interesting will be to observe the interactions between the use of traditional coupons, digital coupons, and the other cents-off shopping behaviors used by consumers, such as mobile coupons, online price comparisons, and smartphone price comparison apps. Already, Symphony IRI reports that wealthier shoppers use e-planning tools more than lower-income shoppers. In addition, they recommend that businesses need to market to consumers at home where many of the shopping decisions are being made rather than in the store.

FIGURE 2 – 4. DIGITAL MEDIA USAGE

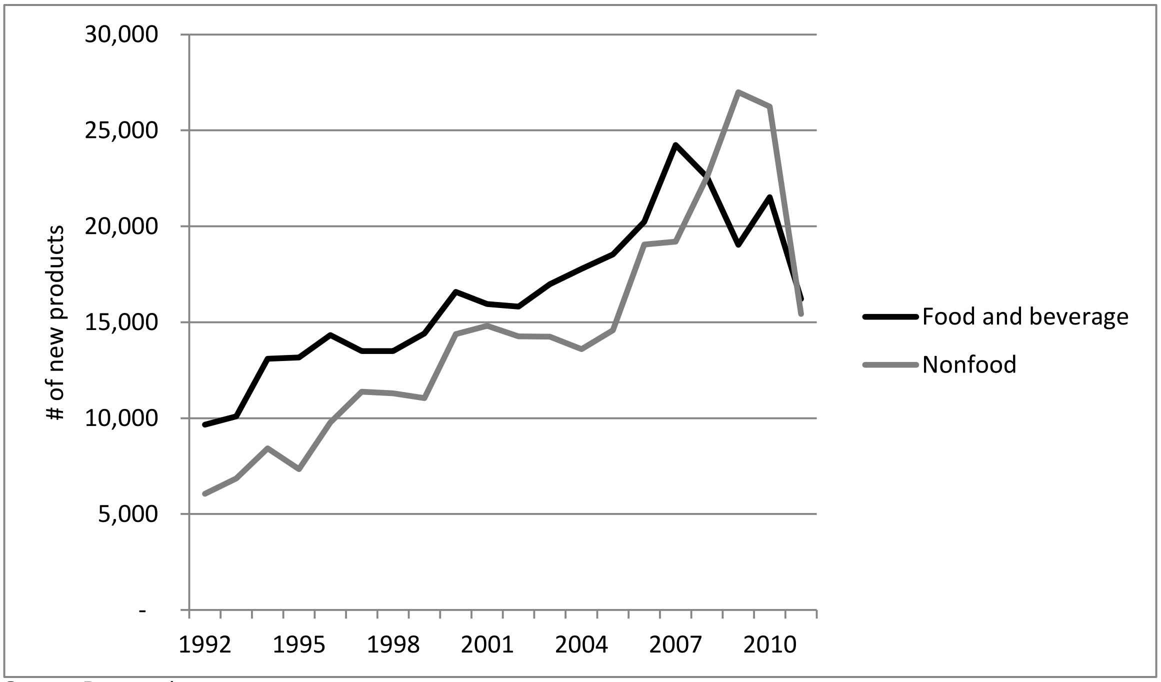


Source: *CPG 2011 Year in Review*, Symphony IRI.

Manufacturing and Retail Trends

Food and beverage and other consumer packaged goods manufacturers introduced at total of 31,649 new food and nonfood products in 2011. New food items totaled 16,212 and nonfood totaled 15,437. This was the smallest number of introductions in a single year since a high of 47,770 in 2010 (Figure 2 – 5). Prior to 2008 new food introductions were greater than nonfood, however, after the recession nonfood items continued their growth until 2011. The decline in food introductions was the first year-over-year decline since 2002. Tightened credit and inventory reduction management on the part of retailers have influenced manufacturers to reduce their new product introductions. In addition, retailers have managed their store assortments more tightly, often eliminating unprofitable product lines and trying to simplify the shopping experience.

FIGURE 2 – 5. NUMBER OF NEW PRODUCT INTRODUCTIONS OF CONSUMER PACKAGED GOODS

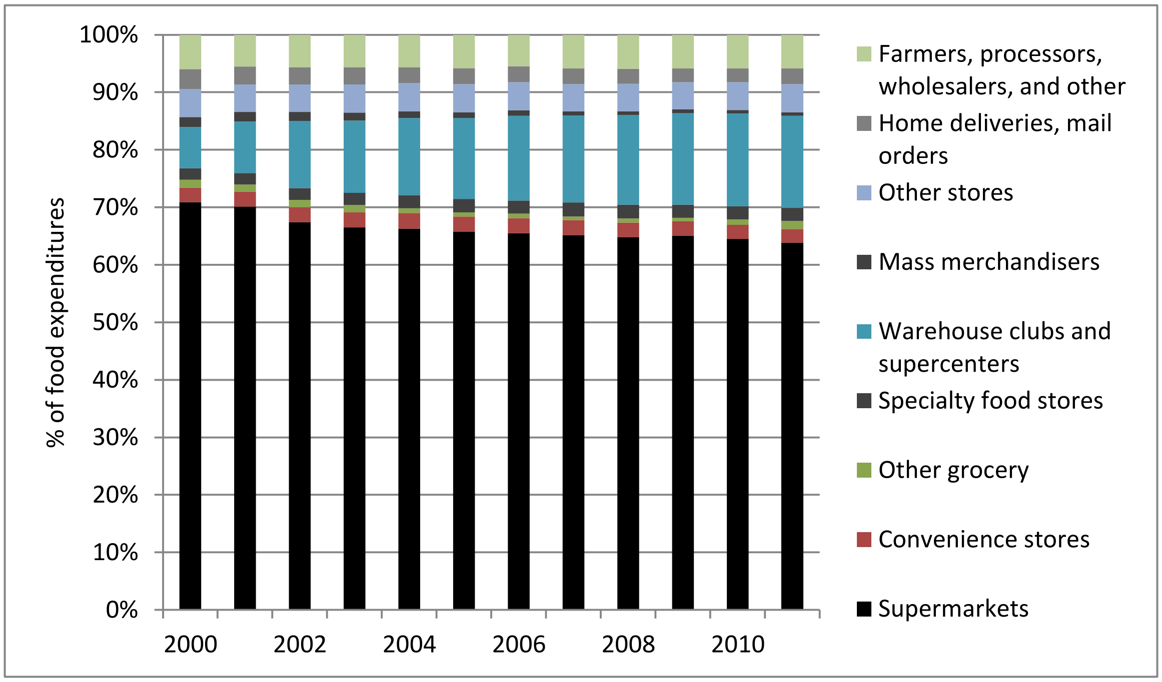


Source: Datamonitor

Supermarket formats continue to lose share to supercenters and warehouse clubs (Figure 2 – 6). In 2000, supermarkets earned almost 70% of consumers' food expenditures whereas in 2011 they earned only 63.8%. Supercenters and warehouse clubs in the meanwhile had a 7.2% share in 2000 and 16% in 2011. One of the newest competitors in retail food is AmazonFresh. AmazonFresh is a subsidiary of the retail powerhouse Amazon. It is test marketing online ordering and home delivery of groceries in the Seattle area. Online ordering and home delivery is offered by a few retailers, most notably Peapod as a part of Ahold USA, and FreshDirect in the New York City metropolitan area, although, historically, the model has logistical challenges that have limited entry by other retailers.

Consumers' interest in local foods and direct marketing continues to grow. However, direct farm sales, captured under the category farmers, processors, wholesalers, and other, have not contributed enough sales to capture share from the other retail expenditure categories. Percent sales from farmers, processors, wholesalers, and other where 6.0% in 2000 and have remained relatively steady since.

FIGURE 2 – 6. SALES OF FOOD AT HOME BY TYPE OF OUTLET



Source: USDA-ERS, Food Expenditures Dataset, table 14. http://www.ers.usda.gov/data-products/food-expenditures.aspx.

The U.S. Food Marketing System Update

GDP lifted manufacturers' moods early in 2012 although the effects of Sandy in the heavily populated East Coast has caused some uncertainties in already softening sales. Unemployment continues to drop but at a slower-than-hoped-for pace. Although these 2 economic measures improved over 2011, the forecasts for 2013 GDP and unemployment do not look as hopeful, as inflation forecasts for 2013 could cause slower economic activity. Consumer price inflation is forecast to increase slightly, to 2.5%, in 2013 and inflation for food at home is expected to increase even more and is forecast for 3.5% inflation (Table 2 – 1).

TABLE 2 – 1. ECONOMIC SNAPSHOT

Economic Measure	2008	2009	2010	2011	2012 (forecast)	2013 (forecast)
GDP (annual % chg)[1]	-0.3%	-3.1%	2.4%	1.8%	2.1%	1.6%
Unemployment (%, SA)[1]	5.8%	9.3%	9.6%	9.0%	8.1%	7.8%
Consumer Price Inflation (% chg)[1]	3.8%	-0.3%	1.6%	3.1%	2.2%	2.5%
Consumer Price Inflation, All Food (% chg)[2]	5.4%	1.9%	0.8%	3.7%	3.0%	3.5%

[1] Historical data from Bureau of Economic Analysis; forecasts The Conference Board
[2] Historical data from Bureau of Labor Statistics; forecasts by USDA-Economic Research Service

Business thus faced with protracted weak demand has even weaker sentiment and has been slow to invest in capital and human capital. Uncertainty over tax rules and the fate of the fiscal cliff, along with continued austerity at the state and local level, further slow the overall pace of demand. Finally, slow growth abroad limits trade prospects. These conditions are likely to keep economic growth below 1.5 percent (annualized) through mid-2013.

CEOs' assessment of current conditions remains weak and they have grown increasingly pessimistic about the short-term outlook. Sluggish growth and a persistent cloud of uncertainty have played a role in CEOs curtailing spending plans this year."

Consumer Confidence Index at Highest Level Since February 2008

TABLE 2 – 2. ECONOMIC INDICATORS

Economic Indicator		November 2012 (change from previous month)
Consumer Confidence	⇧	0.6points
CEO Confidence	⇩	-5.0 points
Employment Trends Index	⇧	0.53%
Leading Economic Index	⇧	0.2%

Source: The Conference Board, http://www.conference-board.org/ accessed November 27, 2012

Food retailers and manufacturers responded to economic downturn. They delayed price increases during increasing commodity prices, dropped prices on selected core staples in response to consumer bargain shopping, increased their focus on private labels, increased face value on coupons, and used aggressive price promotions (sales) to keep prices down and maintain, or even improve, volume. Retail competition was driven by price in the fear that bargain-hunting shoppers, lacking any store loyalty, would turn to competitors.

Consumer Food Expenditures

The USDA-Economic Research Service estimates for 2011 food and beverage sales from retail outlets are in Table 2-3 below. A high consumer price index for food in 2011 contributed greatly to the sales increases. Sales for total food and beverages amounted to almost $1.5 trillion, a growth of 5.5% above 2010 sales. Although the growth in food away from home sales was not shabby, the growth in food at home sales substantially outpaced it at 4.8% versus 6.0% growth respectively. The reason for much of this difference can be attributed to the very low inflation rate (1.9%) for food away from home, as restaurants and other eating establishments held most prices steady in 2011.

TABLE 2 – 3. FOOD SALES[1]

Sector	2011	2010	Growth
	--$ million--		%
Total food and beverage sales	$1,480,692	$1,403,476	5.5%
Total food sales (excluding alcohol)	1,317,828	1,250733	5.4%
Food at home sales	654,422	617,475	6.0%
Food away from home sales	588,926	561,792	4.8%
Alcoholic beverage sales	162,864	152,743	6.6%

[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/Expenditures_tables/table1.htm.

The Consumer Price Index

While the drought in the summer of 2012 caused much uncertainty in the food industry, the effects were somewhat spotty, affecting the grain commodities most heavily. It appears that the effects will not affect food prices unduly. They are having a delayed effect on meat prices and the effects on CPI for food will not be seen until 2013 and those will effect meats primarily.

Food inflation has been decreasing the latter part of 2012, such that the changes in the October 2012 CPI for all foods from year ago levels was only 1.7% (Table 2 – 4). The U.S. Department of Agriculture predicts inflation for all foods to be in the range of 3.0 – 4.0% above 2012 prices. Dairy and fresh vegetable prices are predicted to see higher than average inflation in 2013. Fish and seafood, fats and oils, processed fruits and vegetables, and sugar and sweets prices are predicted to see lower than average inflation.

The lack of consumer confidence in the economy along with continued high unemployment levels are making it difficult for eating establishments to increase prices. The CPI for food away from home is forecast to increase 2.5 – 3.5% for 2013. Although this is better than 2010 and 2011 levels, it is less than pre-recession levels.

TABLE 2 – 4. CHANGES IN FOOD PRICE INDEXES, 2010 THROUGH OCTOBER 2011

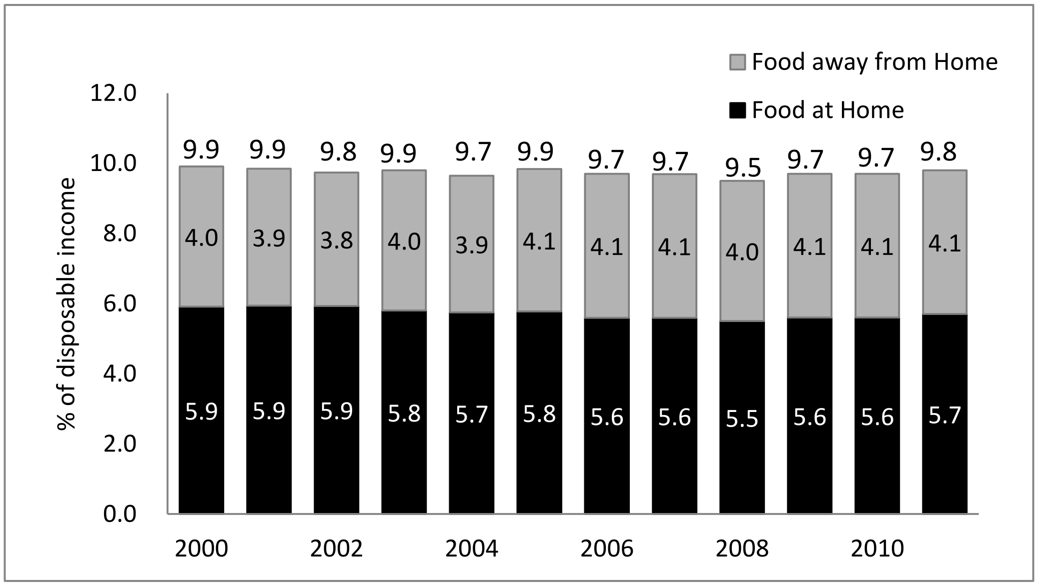
	2010	2011	Oct. 2012[1]	2013 Forecast
		% change from year ago		
All food	0.8	3.7	1.7	3.0-4.0
Food away from home	1.3	1.9	2.7	2.5-3.5
Food at home	0.3	4.8	1.0	3.0-4.0
Meats, poultry, and fish	1.9	7.4	2.4	3.0-4.0
Meats	2.8	8.8	1.7	3.0-4.0
Beef and Veal	2.9	10.2	5.5	3.0-4.0
Pork	4.7	8.5	-2.1	3.0-4.0
Poultry	-0.1	2.9	5.5	3.0-4.0
Fish and seafood	1.1	7.1	1.4	2.5-3.5
Eggs	1.5	9.2	0.1	3.0-4.0
Dairy products	1.1	6.8	-1.1	3.5-4.5
Fats and oils	-0.3	9.3	3.0	2.0-3.0
Fruits and vegetables	0.2	4.1	-0.1	3.0-4.0
Fresh fruits & vegetables	0.7	4.5	-0.4	3.5-4.5
Fresh fruits	-0.6	3.3	2.1	3.0-4.0
Fresh vegetables	2.0	5.6	-3.2	4.0-5.0
Processed fruits & vegetables	-1.3	2.9	1.1	2.0-3.0
Sugar and sweets	2.2	3.3	0.6	2.0-3.0
Cereals and bakery products	-0.8	3.9	0.9	3.0-4.0
Nonalcoholic beverages	-0.9	3.2	-0.4	2.0-3.5

[1] change from year ago October prices. Bureau of Labor Statistics, Inflation and Prices, http://www.bls.gov/data/#prices.

Source: USDA-ERS, Food CPI, Prices, and Expenditures, http://www.ers.usda.gov/data-products/food-price-outlook.aspx

Despite the economy, food expenditures as a percent of disposable income remain low. In 2000, families and individuals spent 9.9% of their disposable income on food. The share disposable person income has increased slightly the last three years, and inflationary increases in food expenditures concurrent with stagnating incomes continue (Figure 2 – 7).

FIGURE 2 – 7. 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/Expenditures_tables/table7.htm .

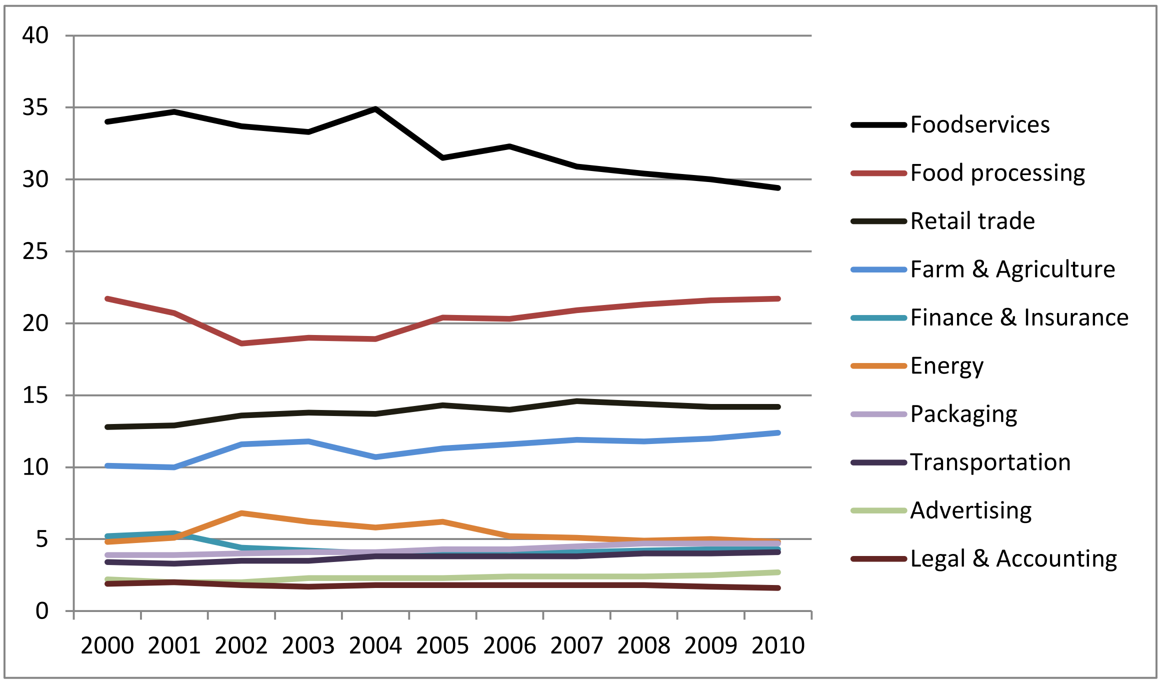
The marketing system in the United States is responsible for all the costs incurred in getting food from the farmers' gate into the hands of the consumer. It divides the system into ten industry groups: farm and agribusiness, food processing, packaging, transportation services, energy, retail trade, foodservices, finance and insurance, advertising, and legal-accounting-bookkeeping services. As the U.S. consumer has demanded food in more convenient forms, these costs have increased at a faster rate than farmers' costs and profits. USDA calculates marketing costs for food produced and consumed in the United States.

A new and expanded food dollar series from USDA-Economic Research Service replaces the old food dollar series. It provides an overview of the food system, with more accurate estimates of the farm share and of the distribution of food-dollar value added shares over time. Highlights from the series include:

- For every dollar spent in 2010 in the U.S. on domestically produced food (food dollar), U.S. farmers sold 14.1 cents of farm products to non-farm establishments (farm share). After spiking in 2007-08, the farm share of food dollar expenditures in 2010 has returned to the 2006 level.

- Foodservice costs contribute by far the greatest share of expenditures. In 2010 foodservice share was 29.4 cents. However the share of foodservice has been declining since 2004, well before the recession in 2008.
- Food processing costs per food dollar have increased 17 percent since 2008 and are now 21.7 cents of the 2010 food dollar.
- The share of food retailers' costs for food-at-home expenditures has declined 7 percent since 2006 to 23.1 cents in 2010.
- Energy costs per food dollar declined nearly 30 percent since 2008 and are now 4.8 cents of the 2010 food dollar.

FIGURE 2 – 8. SHARES OF CONSUMER FOOD EXPENDITURES, BY INDUSTRY GROUP



Source: USDA-ERS. Food Dollar Series. http://www.ers.usda.gov/data-products/food-dollar-series.aspx