GOOD NEWS, BAD NEWS: GROCERY PRICE WARS

By Audrey D. Kline

The changes sweeping across the grocery industry over the past one to two years have been astonishing. While there are likely some variations in different parts of the country, overall, the level of competition has heated up dramatically. Any principles of economics class is likely to teach and preach the virtues of competition—higher quality goods and lower prices due to the pressures of competition. The grocery industry is no different. However, while consumers enjoy the benefits of lower prices, more variety as chains attempt to differentiate themselves, and even new and improved services, grocery store profits are getting squeezed. In the end, will consumers and grocers both lose? Some basic economic concepts can help us analyze what's happening in the grocery industry today.

People might not have been aware of the grocery store wars before Amazon jumped into the market with its acquisition of Whole Foods. This sent shock waves through the industry, dropping prices on some organic products and sending grocery giant, Kroger to an enormous market value loss. As the price wars have heated up in an effort to compete with discounters such as Wal-Mart, grocery stores have been lowering prices on key items to lure in shoppers. Have you seen milk prices at Wal-Mart? In my town last week it was $0.78 per gallon. I didn't need milk but at that price, I put a gallon in my cart. This is precisely what the grocers are hoping will happen. A dozen large eggs have been as low as $0.49.

Not all price cuts are due to competition within the grocery industry. Some declines have been due to deflationary prices as well as decreases in exports of staples such as eggs and meat, leading to a surplus domestically. Since these are perishable goods, prices had to fall to move the surplus off the store shelves. Moreover, the deflationary prices kept prices low for a period of time, but as the economy has recovered, upward pressure on grocery prices has returned. Consumers, however, are accustomed to lower prices, so maintaining lower prices is putting a squeeze on profits for grocers.

Beside the shockwave set off by Amazon's entry into the brick and mortar grocery business, online sales are growing. Amazon's online pantry service was one of the fastest growing business segments for Amazon last year. Amazon Fresh is growing as well. Kroger has introduced ClickList, an online ordering system with delivery to your car parked in designated parking spots. Kroger has rolled out coupons that only work with Click List, too, to try to promote its service. So far, ClickList is a success, boosting online revenue for Kroger

Other pressures on grocery store chains such as Kroger and Wegmans are coming from robust competition from international grocers Aldi and Lidl. These German chains have ambitious expansion plans in the U.S. Both offer a no-frills shopping experience, keep their stores relatively small (think Trader Joe's), but offer very low prices on many grocery store items. Lidl entered the U.S. market last June, opening 10 stores and had expanded to nearly 50 stores by year-end. Lidl plans to double its presence by summer 2018. Aldi has been operating in the U.S. for decades, but opened 150 new locations in 2017 for a total of over 1,750 stores. The two chains are rivals in Europe, and now their rivalry in the U.S. is leading to more price cuts across other grocery chains. Both chains are deep discounters, carrying a small selection of mainly privately branded grocery items. So, what can we attribute to the success of the relative newcomers to the U.S. grocery industry?

Some time has passed since the introduction of generic or store branded products. Initially, quality concerns made it hard to gain traction. However, as time has passed and due to the last recession, more consumers have given private labels a try. Quality has improved significantly and as the economy improved, many consumers did not switch back to name brands. Trader Joe's is an example of private label success, and now Aldi and Lidl are following suit. This is basic economics. When a less expensive substitute (of similar quality) is available, demand for that good will increase. This is precisely what is happening with private labels. It is also what is happening with the shift away from traditional grocers. One online grocer, Peapod, has examined purchase patterns and has found at least 65% of its orders contain at least one store brand item. One of the best examples of the success of less expensive, private brands is Costco's growth of its Kirkland brand. In our local Costco, for example, a box of three Kirkland pizzas can be bought for under $10. Is it any coincidence that Kroger has recently started selling its Kroger brand frozen pizza (select varieties) for $2.99? Compared to name brands like DiGiorno, it's a real bargain and a sample size of my household finds the quality to be on par, if not better than, the name brand. While not all consumers will substitute the private label brands, many will. The benefit of a successful private label brand for the grocer is creating stronger brand loyalty, which increases repeat business for the store.

The expansion in the grocery industry over the past decade combined with the pricing pressure could be leading the industry down a less than rosy path. Looking at the recent fate of department stores such as Kmart, Sears, Macy's and others, the pattern is similar. Big box electronics stores, sporting goods stores, and others have struggled as well. Competition and price cutting in these brick and mortar stores was fierce during the recession to attract consumers. When the economy recovered, consumers were not willing to pay higher prices, and the increase in online shopping didn't help. As a result, profit margins plummeted and several retailers have shuttered stores across the country. Will grocery stores be next? The mom & pop grocery stores are all but gone in many parts of the country.

Survival will depend on innovation to cut operating costs and enable the grocers to maintain price cuts. Is it any wonder there are now more self-service check out lines at the grocery store? Have you tried the apps or hand held scanners that let you scan your items as you shop? This is appealing to consumers but also lowers labor costs for the retailers. On the downside, trying to find help in the grocery store aisles has become a bit more challenging and some people have complained about poorly stocked grocery shelves.

Grocery giant Kroger is poised to invest $9 billion in the coming years to maintain its competitive edge. Among improvements planned, Kroger is revamping its online ClickList's checkout options, expanding self-checkouts in the store, and focusing most on expanding its self-scan ability for consumers—meaning shoppers can scan their items as they shop and skip the checkout line. Sam's Club already employs this technology in its Scan & Go app on smartphones. Kroger also plans some store reorganization and an expansion of home delivery services.

Lower prices and more choices are a boon for consumers at the moment, and the enhanced quality of private label products has led to an increased demand for many of these products while simultaneously enhancing store loyalty. More promotions are likely to be offered to drive consumers into stores. Kroger, for example, has several one day specials on the weekends, ties sales to gas discounts, and promotes its Free Friday Download, which provides an online coupon for an advertised free product only on Fridays. It is safe to say that competitive pressure from Aldi, Lidl, Wal-Mart, and Amazon are contributing to Kroger's efforts to innovate and differentiate itself from other grocers.

Let's hope the industry as a whole is able to innovate and sensibly maintain its level of competition. Otherwise, an eventual shrinking industry will reverse the trend of more choices, convenience, and lower prices at the grocery store that consumers have grown to love.

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