

**FOOD RETAILING IN CANADA:
TRENDS, DYNAMICS AND CONSEQUENCES**

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I. Introduction

Canada, like the United States, is an industrialized country that has seen its retail food sector transform rapidly over the last twenty years. Over the past ten years, in particular, Canadian food retailing has become a highly competitive, consolidated industry that is innovative and constantly adjusting to changing consumers' wants and needs. Marketing of food products in Canada is characterized by strong market segmentation. On the one hand, there are super discount food stores which offer super low prices for the price conscious consumer, while state-of-the art megastores offer exotic, high-priced, high-quality food and non-food items for the more discriminant shopper who is less concerned about price. Canadian food retailing is also increasingly characterized by "banner blurring", as more and more non-food retailers such as convenience stores, drug stores, dollar stores and general merchandisers, offer more and more food items. While increasingly concentrated, food retailing is also increasingly competitive.

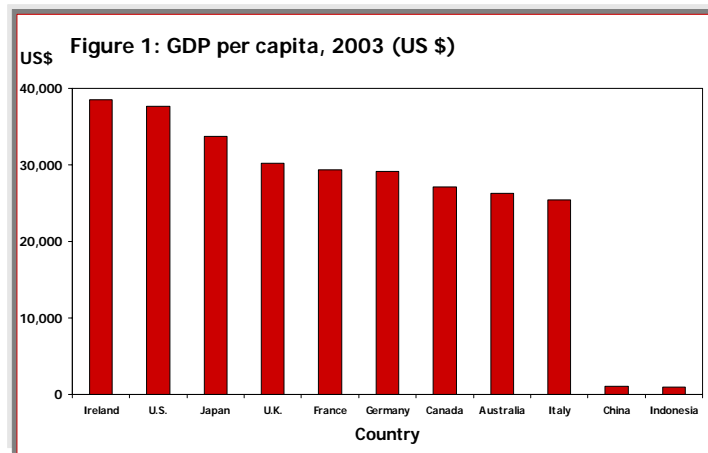
Food retailing in Canada is considered a mature industry, similar to the United States and Europe. Supermarkets, which dominate as the most important retail food channel in North America, now account for 80% of retail food sales in Canada. As Reardon argues in his study of Latin American food markets, it took over 50 years for supermarkets in the U.S. (and Canada) to grow to account for over 60% of total food sales, but only a decade for the same development to take place in Latin America. (Reardon and Berdegue, 2002). Dramatic developments are also taking place in Chinese and Southeast Asian food retailing where supermarkets are growing in importance as well. But will this trend continue in Canada? Given the emergence of non-traditional retail outlets increasingly offering food products to compete with the supermarkets, is it possible that this trend will now reverse itself or level off?

The purpose of this paper is to discuss the state of food retailing in Canada, and present recent trends, dynamics and consequences for the sector that may influence future developments as well as the policies that affect them. The first part of the paper will describe Canadian consumers and the influence they are having on food retailing. The second section will discuss the structure, conduct and performance of the food retail sector in Canada including the changes that have taken place in recent years. These changes have occurred as a result of rapidly evolving consumer and market demands in Canada and abroad and the emergence of large multi-nationals revolutionizing food retailing around the world. The third section will consider the impacts these changes in the retail food sector are having on primary agriculture and other players in the supply chain, including trade. The paper will conclude with a discussion of the policy implications of these recent developments and the role government may need to play in addressing impacts on the supply chain.

II. The Canadian Consumer

Canadian consumers, like those in the United States and Europe are some of the wealthiest in the world. This is because Canada's economy, like its industrialized neighbours, has grown and flourished due to a well-developed manufacturing and service sector, capital infrastructure, political stability and a well educated labour force. Gross Domestic Product of \$1,092 billion in 2003 was distributed over thirty one million Canadians so that GDP per capita averaged \$US 27,000 in Canada. This compares with \$US 37,648 in the United States, \$US 29,115 in Germany, and \$US 29,410 in France (Figure 1).

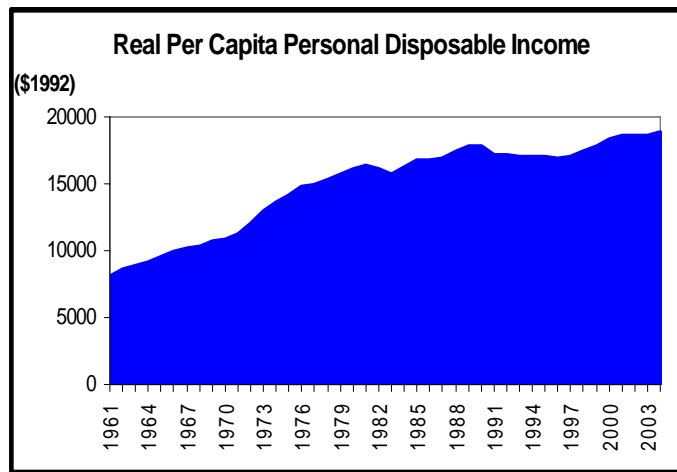
Figure 1: GDP per Capita, 2003



Source: World Fact Book

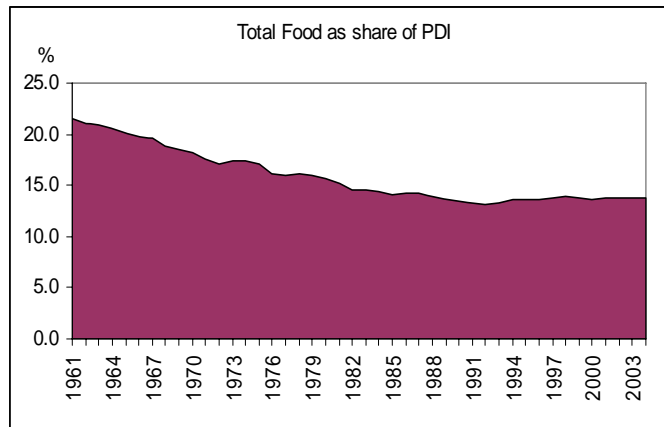
Income is considered a major driver influencing the demand for food and retail food products. According to economic theory, as income rises, the share of a consumer's budget allocated to food falls (Deaton and Muellbauer, 1981). Indeed in Canada, as income has risen (Figure 2), the share of personal disposable income allocated to food and non-alcoholic beverages and meals away from home has fallen over time. In 1961, Canadians spent 21.7% of their income on food, non-alcoholic beverages and meals away from home and this fell to 7.9% by 2004 (Figure 3).

Figure 2: Real Per Capita Personal Disposable Income, 1961 to 2004



Source: Statistics Canada

Figure 3: Share of Personal Disposable Income Spent on Food, 1961 to 2004



Source: Statistics Canada

Economic theory also explains how budgets will be allocated across food items. Some goods and services and food items are “inferior goods”, because they decline in importance in consumers’ food budgets as income

risers. Bread and potatoes have traditionally been called “inferior goods” for this reason. Other items, such as meat have traditionally been considered “luxury goods”, which rise in importance in consumers’ budgets as income increases. However, given that Canada has been industrialized for some time, even meat is no longer rising as a share of budgets. Instead, Canadians are looking to increase the quality and services on which to spend their rising income. As a result, a greater share of personal income now goes to meat cuts that are of a higher quality (eg. Sirloin steak, halal meat). Canadian consumers are also spending more on restaurant meals and retail food items that include quality attributes and services, such as convenience, variety, new tastes (eg. Thai) and origins, enhanced health characteristics and nutrients and new processes and production methods (eg. Organics). All of these developments are influencing the changes that are taking place in the food retailing sector.

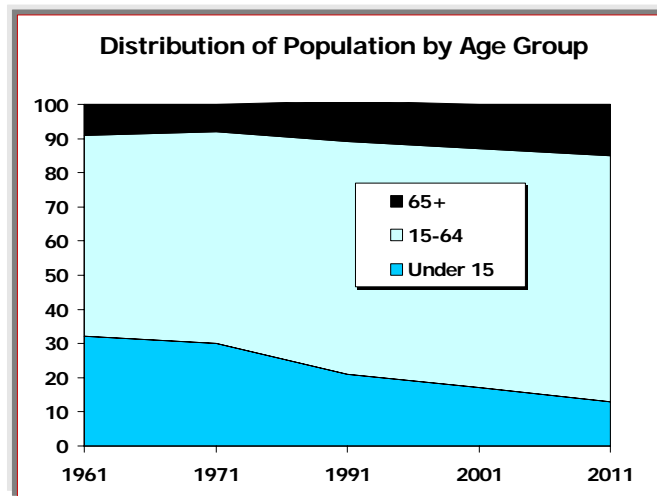
Even though Canadians’ income has risen over time in aggregate, there are still some Canadians with low income, who have more difficulty providing for themselves and their families. In 2002, the incidence of low income was 7% for all economic families, as measured by the share of families with income below the “Low Income Cut-off¹”. This is down, however, from 9.1% in 1991. One of the major factors influencing the “low income rate” has been the increasing number of lone (single) parent families who are having a difficult time making ends meet. Incidence among these families is 34.8%, by comparison. Most of these families also reside in urban areas where living costs tend to be higher. However, there are more food banks and social services available in urban areas to help these lower income consumers, who will always be struggling to buy adequate, nutritious food.

Canadian consumers, like those in other industrialized countries are aging. This is because of a low fertility rate that is well below the replacement level of 2.2% and a population growth rate that is almost zero. The share of the population that is over age 65 now stands at 13% in 2004 compared to 8% in 1971 (Figure 4). The share of the population under 15 years of age has fallen to 17.9%, down from 30% in 1971. This group is the future labour force who will be called upon to support the large aging cohort of baby boomers who will increasingly be putting pressure on the health care system and require special goods and services in the future. An older population tends to purchase smaller portions that meet specific nutrition requirements for special health needs. The growing popularity of functional foods and natural food products, low fat food items, fresh fruit and vegetables

¹ Economic families are defined as a group of two or more persons who live in the same dwelling and are related to each other by blood, marriage, common-law or adoption. The “Low Income Cut-off” is the income threshold at which a family would typically spend 20 percentage points more of its income than the average family on the basic necessities of food, shelter and clothing.

and fortified foods reflects this growing interest in healthy food items by an aging population. Obesity has become an alarming health concern in Canadian adults, but also in children: 23% of Canadian adults were obese in 2004, up from 14% in 1978/79. This threatens to raise future health care costs for society and will continue to grow in importance as an important factor affecting retail food choices in the future.

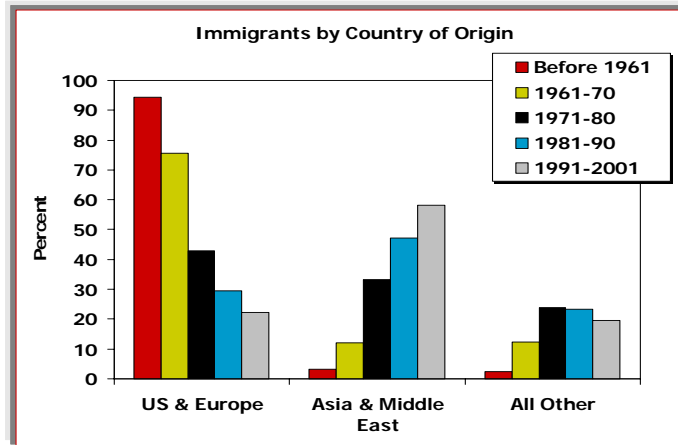
Figure 4: Share of the Population by Age Group



Source: Statistics Canada

Any increases in population more recently have been influenced by immigration into Canada. Between 2003 and 2004, there were 239,000 immigrants entering Canada, up from 160,000 in the 1980's. Increasingly, the number of immigrants into Canada has been persons from countries in Asia, including China, India, and Pakistan, the Middle East and Eastern Europe (Figure 5). Given that traditionally, most immigrants were from Western European countries and Great Britain, this change in immigration patterns has affected the variety of food and food items that is being offered in grocery stores. And as Canadians have traveled more extensively, they have also been introduced to many of these foreign cuisines, such that we now increasingly see exotic food items in the grocery stores that Canadians have been exposed in their travels. It is fashionable to serve food with new tastes and origins that are considered "exotic" and consumers are looking for these items in Canadian grocery stores. Additional discussion on this and other factors influencing Canadian consumer tastes and purchasing habits can be found in AAFC (2005).

Figure 5: Immigrants by Country of Origin

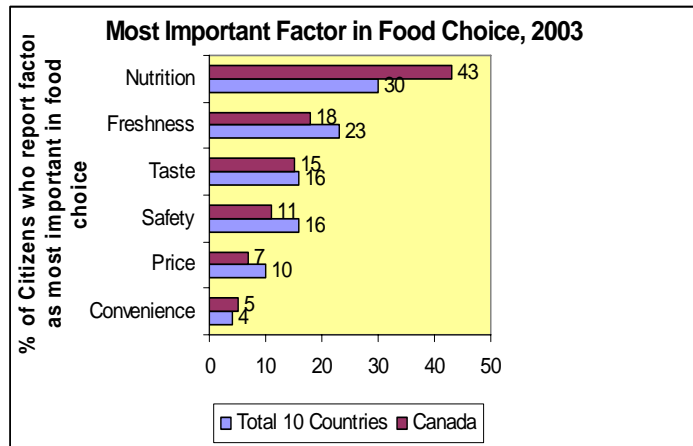


Source: Statistics Canada, Census of Population

Recent opinion polls that have been conducted to measure Canadians' opinions regarding food and food issues provide an indication of the factors influencing Canadians' purchase of food in Canada. Globescan Inc. conducted a poll of citizens from 10 countries between May and October 2003, posing questions about everything from top food concerns to factors influencing food purchases, from BSE, to obesity and health concerns to the role of government versus industry in ensuring food safety. As Figure 6 indicates, fewer Canadians reported food safety as their number one food concern (11%) compared to citizens in the other nine countries surveyed² (16%). However, more Canadians reported nutrition as the number one food concern (43%), relative to other countries. Price, while important to many Canadians, is less of an issue (7%) than for citizens in other countries (10%). Convenience, on the other hand, is of major importance to an equal percent of citizens in Canada (5%) as in other countries (4%).

² The survey was conducted in China, Brazil, Mexico, Canada, United States, France, Germany, Italy, Spain and Great Britain.

Figure 6: Percent of Citizens who Rate Various Food Issues



Source: Globescan, 2003

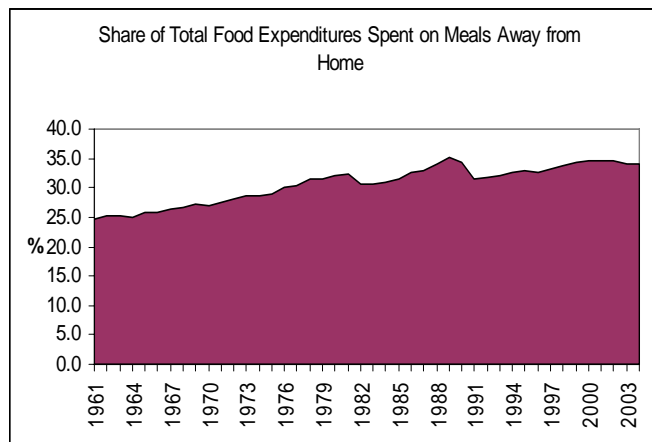
The importance of price, while not identified as a number one concern for most Canadians in the survey, is clearly important to many Canadians given the popularity of super discount food warehouses, dollar stores and general merchandisers in Canada. Most major retail chains have at least one banner in their operations that offers discount prices. Loblaw's has its "No Frills" and "Valu-Mart" stores, Sobey's has its "Price Chopper" and Metro Inc. has its "Super C" and "Food Basics" (with the recent acquisition of A&P). The rise in the number of Wal-Mart stores in Canada that offer the "lowest price is the law" has awakened Canadians to their desire for low prices. It is argued that the threat of competition from Wal-Mart has meant that most major food retailers are offering lower prices to be able to compete and maintain market share. And while higher incomes have meant that consumers can spend more on restaurant meals and higher priced, high quality food items, Canadians still like to get a good deal. A long-standing retail marketing strategy that continues to be prevalent in retail food stores is the strategy of selling "loss leaders", in which certain food items, such as milk and bread, are sold below margin to attract consumers into stores. Another strategy is the use of coupons, provided by major food manufacturers to save money on grocery items.

Perhaps the most important development to appeal to consumers looking for lower prices in grocery stores is the expansion of private labels. In 2000, private labels had penetrated 23.1% of the market, up from 16.7% in 1988. Loblaw's, for example, has its "President's Choice" line of food items while Metro Inc has its "Merit Select". Many of these items are lower-priced

“no-name” versions of brand products, developed to offer lower prices to consumers. More recently, President’s Choice items are recognized for their quality, such as being innovative, exotic, made with all natural ingredients, healthy and free of preservatives or artificial colouring. All of the major supermarket chains in Canada offer private labels that vary by chain.

Convenience is another important factor influencing Canadian consumers’ food choices, even if it is not the most important issue. Globescan found that only 5% of Canadians reported convenience as the most important food issue (Figure 6). However, convenience has altered the nature of products being offered in grocery stores and the time spent preparing meals inside the home. The dramatic rise in the share of the food dollar spent on restaurant meals and take-out and prepared food products from grocery stores is testimony to Canadians’ desire for convenience. The share of total food expenditures allocated to restaurant meals continues to rise in Canada, from 24.6% in 1961 to 33.9% in 2004 (Figure 7).

Figure 7 Share of Food Expenditures Spent on Meals Away from Home



Source: Statistics Canada

Food retailers are responding to this demand for convenience by increasingly offering in-store delis and more ready-to-eat prepared foods such as prepared salads, chicken and sushi (USDA, 2003). These services are often not offered as a profit builder but serve to drive traffic into the stores. Food manufacturers have introduced an increasing selection of frozen and prepared meals for consumers seeking a quick meal from the grocery store. Data from the Family Food Expenditure Survey show that between 1982 and 2001, the proportion of the household food dollar spent in stores on “other foods, materials and food preparations” rose from \$.06 in 1982 to almost \$.10 in 2001. Data from ACNielsen on retail dollar sales of various food items in the largest grocery stores for the past four years, have shown frozen food sales increase on average by 8% a year, between 2000 and 2003.

The female participation rate, which has stabilized more recently at 62.1% in 2004 after rising steeply through the 1970's and 1980's from 45.7% in 1976, provides an indication of the extent to which women have joined the labour force and thus have less time to prepare meals for their families. According to the 1998 Time Use Survey, Canadians over age 15 years spent 7.7 hours per week preparing food for their families, whereas data from the United States shows that in 1967, the average adult spent 10 hours per week doing food related activities. In an effort to respond to this demand for convenience, one of Canada's major food chains, Sobey's, has launched a new concept whereby an express grocery store is paired with a Canadian Tire gas bar and a Star Bucks coffee outlet. These are called Q stores for Quick.

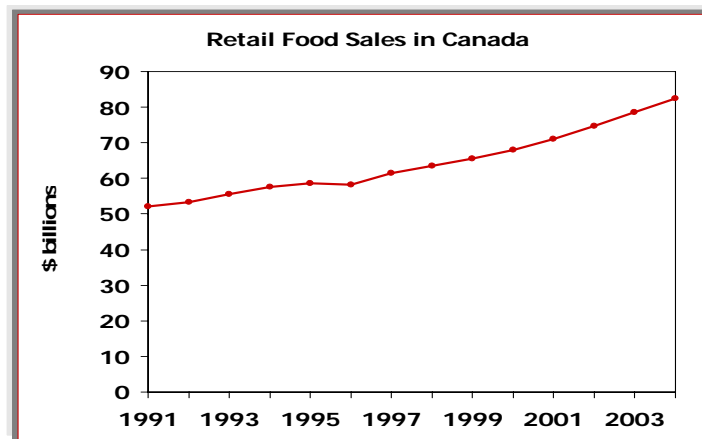
All of these factors are driving the demand for food in Canada and food retailers are responding by offering food items and services that address these demands. In the increasingly competitive environment that is the retail food sector, retailers are undergoing transformation in structure, conduct and performance to be able to respond to consumers' demands.

III. The Retail Food Sector in Canada : Structure, Conduct and Performance

i) Structure and Conduct

In 2004, retail food sales rose to \$82 billion in Canada, up from \$78 billion in 2003 (Figure 8). This compares to 1991, when retail food sales were \$52 billion, reflecting an increase of 58% over this period. However, food store sales have slowed in recent years, after adjusting for inflation, primarily due to a slowdown in population growth and because the industry is a mature industry.

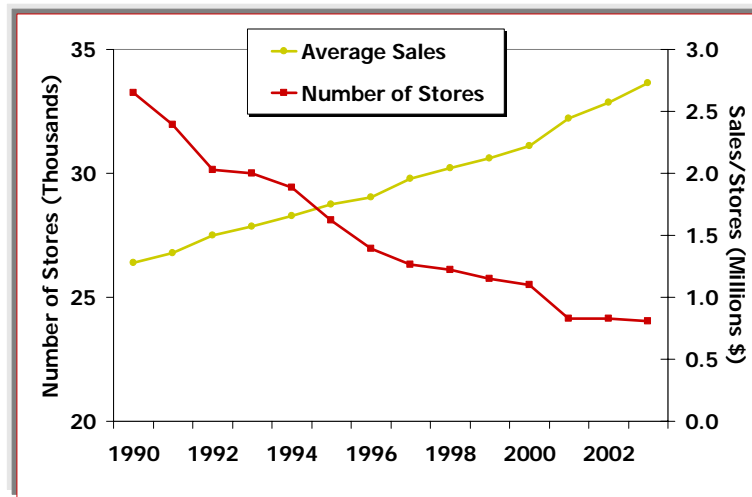
Figure 8 Retail Food Store Sales in Canada



Source: Statistics Canada

At the same time, the number of food stores, such as supermarkets and specialty food stores has decreased over time (Figure 9). The number of food stores fell from 33,000 in 1990 to 23,000 in 2003. Together with increased sales, this has meant that average sales per store has risen substantially, from almost \$1 million per store in 1990 to \$3 million in 2003. Data for 2004 and 2005 will probably indicate a continuation of this trend as consolidation and the construction of increasingly large superstores are redrawing the retail food landscape in Canada.

Figure 9 Number of Retail Food Stores and Average Sales



Source: Statistics Canada and AAFC

Prior to July 19, 2005, there were five major supermarket chains in Canada with 82% of the retail food market share: Loblaw's with over 1,600 stores across the country, accounting for 40% of food sales, Sobey's with 1,300 stores and 18% of sales, Canada Safeway with 200 stores and 8% of sales, Metro Inc. with 343 stores primarily in Quebec and 9% of sales, and A&P with 230 stores, primarily in Ontario accounting for 7% of sales (Figure 10). As a result of the acquisition that was announced July 19, 2005, whereby Metro Inc will purchase A&P Canada from its owner Tengelmen of Germany, Metro Inc will move from a primarily Quebec-based food retailer into the highly competitive Ontario market. After the acquisition, it will have over 500 stores and 16% of the Canadian retail food market.

Figure 10: Major Retail Food Chains, 2004

Retail Food Chain	Number of Stores	Share of Retail food Sales
Loblaw's% Co. Ltd	1,600	40%
Sobey's	1,300	18%
Metro Inc.	343	9%
Canada Safeway	200	8%
A&P	230	7%

Source: Company Reports, Globe and Mail.

The rise of the “superstore³” or “megastore” in Canada is a recent phenomenon that has taken place primarily over the last five years. Of the five major food retail players, Loblaw's and Sobey's, the top two players, have adapted this strategy of building increasingly large-sized stores and offering an increasingly diverse array of food and non-traditional food items and services to appeal to consumers who are especially interested in “one stop shopping” . Non-food items can be sold at higher profit margins than traditional food items at retail food stores. Loblaw's, which used to build stores that were under 50,000 square feet in the 1980's, is now constructing large superstores that are up to 120,000 square feet (AAFC, 2004, p. 14). While food continues to be its main business, Loblaw's increasingly has a larger share of its sales from general merchandise (drugstore items, DVD's, clothes, wine) and services (take-out food, financial services, drycleaning, photofinishing and entertainment)-from 25% to 40% of sales. Several large megastores have even opened in conjunction with women's fitness centres. This phenomenon, toward larger supermarkets and an increasing share of general merchandising, has been termed the “Wal-Martization” of food retailing in Canada, as food retailers, in general, and Loblaw's, in particular attempt to stave off competition from this large multinational that continues to expand around the world. Thus far, Wal-Mart Canada, has concentrated its expansion in Canada of traditional general merchandise outlets in larger urban areas. It has not, as yet, entered the full-fledged grocery store business in Canada, as it has in the U.S (Smith and Trant, 2002, pg. 1).

At the same time as traditional supermarkets are offering a broader selection of non- food items, other retailers such as department stores,

³ A superstore or supercenter is defined as a store over 85,000 square feet with at least 40% of space given over to general merchandise (AAFC, p. 15).

drugstores, convenience stores, gas bars and even dollar stores are increasingly offering food items, so that “banner blurring” is taking place. Therefore, while supermarkets continue to be number one in the food sales business, general merchandisers (Wal-Mart), club warehouse stores (Costco), drugstores and gas bars are quickly following with growing food sales(Figure 11). Even dollar stores are entering the fray, offering food items in a “convenient” retailing environment to appeal to consumers in a hurry.

Figure 11: Share of Retail Food Sales by Channel, 2002

Channel	Share (% of food sales)
Supermarkets	80.1%
General Merchandise Stores	9.7%
Specialized food Stores	7.3%
Drug Stores	1.4%
Gas Stations	1.0%
Other	0.3%

Source: Statistics Canada, Canadian Economic Observer, Dec. 2003

Food retailing must also increasingly compete with the food service industry for the Canadian consumer’s food dollar. It used to be that consumers had only two options for acquiring food in addition to growing their own, that is: 1)to buy food from grocery stores and prepare meals at home, or 2) to purchase restaurant meals. Over the past ten years, there has been a boom in the number and variety of fresh and frozen prepared meals and take-out food from deli counters at grocery stores. Nevertheless, spending on meals away from home, has continued to rise (see Figure 7). The food retail industry has attempted to cash in on the consumer’s desire for convenience by increasingly offering already prepared food and meals, both in store delis and in the freezer case. However, it is unclear, whether this phenomenon, which grew by leaps and bounds in the 1980’s, will continue to transform food retailing in the near future. Only consumers’ purchasing power and income and desire for convenience will keep this trend growing.

As mentioned previously, there has been a dramatic increase in the amount of consolidation and concentration in food retailing in North American over the last five to ten years in particular. Figure 12 shows that, in 2002, the market share of the top five food retailers in Canada was lower (63%) than for many other European countries. However, relative to the United States, Canada has a more concentrated food retailing industry. With the recently announced acquisition of A&P Canada by Metro Inc., Canadian food retailing will become even more concentrated. While concentration levels are rising, it is unclear whether this increased concentration is leading

to greater market power and unfair competition on the part of food retailers (Smith and Trant, 2002). On the contrary, super low profit margins, which are a characteristic of the retail sector, continue to reflect the intense competition that occurs in this industry, especially given the emergence of more competitors in general merchandising, convenience stores and drugstores. This is certainly an area that requires further research before conclusions can be drawn.

Figure 12: Market Share of the Top 5 Food Retailers

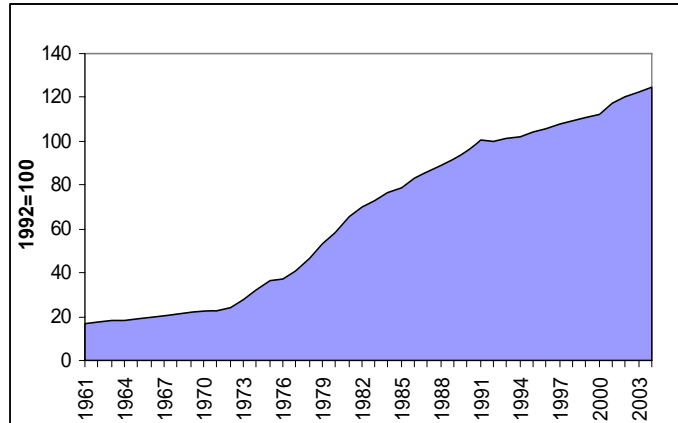


Source: AAFC, "An Overview of the Agriculture and Agri-food Sector".

ii) Performance of Food Retailing in Canada

Food retailing in Canada has recently been characterized by rather unspectacular growth in revenues. Real retail sales of food and beverage stores rose by only 2.8 percent in 2004, in part due to modest growth in output and competitive pressures on prices. Greater diversification of product offerings by food retailers has helped to support growth in sales despite the maturity of this sector. In the near future (2005 to 2009), growth is expected to be somewhat better at 5.1% per year, evenly distributed between increases in volume and prices. The benefits from diversification are expected to wane and competitors in other retail segments are expected to capture more of the market for food sales (Conference Board of Canada, pg 11). Revenue growth is coming primarily from output growth, since price increases tend to be moderated by competitive pressures. Retail food prices rose only 2 % between 2003 and 2004 and only 12.8% over the five year period 1999 to 2004 (Figure 13).

Figure 13: Retail Food Price Increases (CPI-Food)



Source: Statistics Canada

On the cost side, operating expenses in food and beverage retailing have been keeping pace with revenue increases so that the net effect on profits has been stable, according to Statistics Canada (CBC, p. 11). Cost control is key to the success of the food retailing sector. One of the ways food retailers are limiting cost increases is by increasing investment in cost-saving technologies. Investment as a share of revenues has risen in recent years and is now higher than other major retail groups at 2.3% compared to 1.5% for all retailers. Loblaw's has been a leader in cutting costs with new investments in cost-saving technologies, such as self service check-outs and "Just in time" inventory controls in an effort to lower costs and compete with non-food retailers and other grocery store chains.

Capital costs as a share of total costs have risen in the face of this increased investment, but remain small at 2.6%. This is because of low interest rates and the ability of food stores to finance much of the new investments from operations. This trend is expected to continue.

Material costs represent the largest share of costs, at 85% and thus are the major focus of efforts to manage costs. Material costs rose by 2.9% between 2003 and 2004 with the increase being driven equally by higher input prices and increased volume in the amount of inputs used. Over the near term, material costs are expected to rise by an average of 5.1% per year. The concentration of buying power in a handful of large companies will help keep the rise in input prices modest over the period. Thus, increasing

volumes of products sold will account for the majority of the gains in material costs (CBC, p. 11).

Labour costs for food and beverage retailers have always been a major cost given the relative labour intensity of this sector. These costs, which represented 12% of operating costs, rose by 2.8% in 2004, keeping pace with inflation. Most of the gain came from higher wages. Increasing productivity is one of the major goals of food retailers in Canada as they compete with very low margins. However, this leads to higher wages. Therefore, labour costs will continue to be one of the major factors driving up costs and encouraging food retailers to make even further productivity gains if they want to manage costs.

As a result of operating cost increases that have more or less been matched by revenue increases, profit margins in food and beverage retailing have remained very stable at around 2%. Profit margins are expected to rise between 2005 and 2006 as food retailers benefit from the recent investments in new stores and technologies that they have made over the past few years.

IV) Implications for Consumers, Farmers, Processors, Wholesalers and Trade

The future performance and profitability of the food retail sector in Canada will clearly be dependent on individual food retailers' ability to compete in this highly competitive retail environment, to keep costs low, to continue to invest in new stores and technology, to meet consumers' demands for fresh, exotic and diverse produce, to offer innovative products and services, to deliver in diverse markets at super low prices or high priced high quality markets while warding off competition from non-food retailers including the largest, most competitive, general merchandiser in history-Wal-Mart.

i) Impact on Farmers, Processors and Wholesalers from Changes in Procurement Methods

One of the methods by which food retailers have been able to reduce transaction costs at the same time that they have been able to ensure supplies of high quality, diverse products, has been through strengthening marketing relationships with suppliers. While retailers have traditionally made use of importers, brokers, distributors and wholesalers for their suppliers, increasingly they are contracting directly with farmers and processors or integrating vertically. For example, most of the major retail food store chains have acquired their own dairies to supply fluid milk and dairy products to their stores. For example, Loblaw's Co. Ltd owns a significant share in Nielsen's Dairy. And whereas food retailers previously

made substantial use of brokers, wholesalers and distributors to acquire their grocery store supplies, increasingly they are making use of their own specialized procurement officers who purchase directly.

Perishable products in particular, such as dairy, produce, meat, poultry and value-added items are often procured direct by the large retailers. Some retailers such as Loblaw Co. Ltd and Sobey's Inc. employ procurement offices in the southern U.S. for this purpose. In the grocery aisles, however, retailers rely heavily on brokers, importers or distributors (USDA, p. 16). In 1999, 25 to 30 percent of store inventory was delivered directly to the retailer by the processor, and this percentage is probably higher today. There has been significant consolidation in the food broker business in North America over the past twenty years. In 1986, for example, the Canadian Food Brokers Association boasted 100 members, while by 2001 it had fewer than 45. Today, the Association no longer exists, having merged into the Grocery Manufacturers of America which lists 30 Canadian agencies. The Food Wholesaling business in Canada is therefore much more consolidated today than it was twenty years ago and this too has implications for other players in the supply chain.

In their study of Latin American supermarkets, Reardon and Berdegue (2002) discuss the role of procurement in the evolution of food retailing in South America. Generally, their findings apply to developments in North America as well. Stiff competition among food retailers has led to cutting costs by improving all aspects of procurement including product and transaction costs (Reardon, p. 381). This has been done by means of improvements in coordination and logistics systems, such as distribution centers, logistics platforms, contracts with wholesalers and producers, and private standards specifying quality, safety, volume and packaging of products. In general the above requirements have meant substantial new investments in capital and into new practices and management by suppliers relative to the traditional system (Ibid.). The increasingly large scale of supermarket chains gives them the capacity to pursue economies of scale and volume of procurement since they have the bargaining power, the finance to make investments in logistics and the geographical presence required (Reardon, p. 379).

However, what is the impact on farmers? Through contracts, private standards, sourcing networks and distribution centers, they are quickly reformulating the rules of the game for farmers and first stage processors. The authors use the example of fruit and vegetable producers in Chile and Mexico to show how the small scale of production is often not sufficient to offset the costs of supermarket procurement practices (ie long term payments, high rates of rejected produce, and supermarket fees such as shelf fees and

special discounts). It is hard for small producers to ensure product homogeneity, coordination of harvest, centralized grading, sorting, packaging and delivery and they often do not have the management and business skills and accounting knowhow to manage these business arrangements (pg 382). Clearly, farmers must adapt to the new demands of the market place by upgrading management skills, forming alliances with other producers and/or their clients to reduce transaction costs, accepting standards and processes that can help them signal quality differences and client specifications.

ii Impact on Farmers from Changes in Market Power

In Canada as in other countries, there are questions surrounding the increase in food retail concentration and whether this results in increased market power. In the economic literature, it is argued that under conditions that are not perfectly competitive, such as under oligopoly, when there are only a few sellers, prices will be higher than under perfect competition (Cotterill, 2000), and therefore profit margins may be an indicator of market power. Smith and Trant (2002) studied rates of return in food retailing in Canada in an attempt to determine whether market power in food retailing was being “exercised” over the 1990’s in Canada. The authors found that rates of return, as measured by the operating rate of return on long-term capital for grocery retailing and food retailing (12.68% and 12.15% respectively), were much larger than the rate of return for non-food retailing (6.99%) or the general economy (7.33%). Large firms in particular registered the highest returns; almost double those of small and medium-sized food retailers. Given that food price increases over this period were very small (Figure 13), they argued that increased returns came from large cost saving measures and new technologies that increased efficiencies for the large grocery store chains. They concluded that higher rates of return in food retailing were more the result of lower costs from increased efficiencies rather than from higher prices resulting from market power.

In the presence of market power, it has been argued that farmers may receive lower than competitive farm prices and consumers may pay higher than competitive prices (Reed and Clark, 2000, p. 1)). There are many papers looking at price spreads and price changes that attempt to indicate whether market power in food retailing is resulting in unfair competitive practices of retailers especially relative to their input suppliers (ie farmers and processors) and consequently higher returns to retailers than other players in the food supply chain. Larue and Gervais (2005) recently studied farm to wholesale and retail price spreads of various agricultural commodities in specific regions in Canada to determine whether market power was influencing price spreads and market returns for farmers. They found that while there seems to be evidence of decreasing price spreads between retail

and wholesale prices, the retail margin has generally increased in recent years, except in the case of dairy products. The wholesale to farm retail margins were stable with a slight negative trend for pork and chicken while it has increased in the beef and dairy sectors. They are therefore not able to infer anything about the existence or absence of market power at any level of the market. And given that Canada is a small player on world commodity markets, trade liberalization is probably the best tool to mitigate increasing price spreads since trade and market integration discipline the exercise of market power (Larue et al. p. 43).

ii) Impact on Trade

Trade liberalization and globalization have no doubt facilitated the changes in procurement methods by grocery chains and the accompanying emergence of large multinational food retailers over the past decade. These have in turn led to the dramatic changes that have been occurring in the structure and performance of food wholesaling and retailing in Canada and abroad. As mentioned above, the number of Canadian food brokers declined significantly over the past decade as major grocery store chains hired their own procurement officers in head office or made use of the large North American brokers. Consolidation in procurement has meant that there are fewer and fewer buyers of world commodities who are better able to exercise their own market power. They can source supplies from around the world more easily and demand product diversity and quality specifications for the retail food chains. For the consumer this has meant a greater variety and selection of produce and products from around the world that previously were not available in grocery stores. For farmers, this implies that there is greater competition from abroad from other producers who may be willing and able to provide those products and quality specifications that food retail chains want. The development of world-wide supply chains through which retail food chains source their products has increased the level of trade that is taking place. Canada was able to achieve a 4% share of world agriculture and agri-food exports by 2001 as a result. However, recent developments such as the appreciation of the Canadian dollar relative to world currencies and the BSE crisis have tempered export growth since 2003. Nevertheless, Canadian agri-food exports still averaged \$24.4 billion that year.

V Conclusions

Food retailing in Canada, like that in the United States and other countries of the world has been evolving rapidly. There has been increased consolidation and concentration of food retailers and grocery store chains in particular. However, emerging competition from non-food retailers and

general merchandisers, such as Wal-Mart in Canada has offset this rise in concentration so that consumers have actually benefited from lower prices, greater product diversity and quality and service. Most supermarkets today offer a greater range of goods and services so that consumers with time constraints can benefit from the “one stop shopping experience”. Everything from food to drugs to dry-cleaning to photofinishing and clothing and furniture are available in many large grocery stores. At the same time, low discount prices are available for those consumers looking for low prices and no-frills. In order to succeed, Canadian producers selling to larger, more concentrated food retail chains will be required to improve their management skills and accounting practices, meet standards and specifications and invest in new technology to meet the demands of domestic retail chains or international chains if they want to sell abroad.

Globalization and the growth of international supply chains and large food retailing multinationals have meant that products are being sourced from all over the world, for consumers to purchase in their local grocery store. Immigrants from India and China can find produce and goods in Canadian grocery stores that they grew up with in their home countries. Canadians, at the same time, who have developed exotic tastes from traveling, can find the ingredients for this ethnic cuisine.

Rising income in Canada means that more Canadians have the income to purchase increased quality and services associated with their food purchases. Those willing to pay more for organic produce can find these products in their grocery stores, while others wanting fine cheeses from Italy and France, can find these products as well. Quality is what many consumers want, and this implies that traceability systems and quality signaling will be required to ensure that consumers trust that what they are paying for indeed delivers the quality attributes they want.

Food retail chains have responded to the changing tastes and preferences of consumers by developing private labels and brands and introducing new products that consumers will buy. The increased consolidation in food wholesaling and procurement has meant that fewer and larger brokers are sourcing the products for grocery stores. World wide supply chains have been developed to source a greater array of exotic products, thereby increasing trade. However, this implies greater competition for domestic farmers and processors who must compete with players from around the world. Canadian producers must tap into these supply chains through their own commodity organizations, cooperatives or value chains in order to compete in this ever changing food retail market.

There are several areas where the government can facilitate adaptation to this changing retail food market. To address the concern over market power and concentration, Canada's Competition Act and Anti-trust legislation allows monitoring of mergers and acquisition in food retailing in Canada. The government can work to ensure the Act is amended to address emerging concerns.

In order to help producers who must increasingly compete in more demanding food markets, the government can adapt marketing institutions and regulations to help facilitate trade and signaling of quality from producers to consumers. For example, with asymmetric information in product markets, consumers will be unsure of the quality attributes of products and will not buy them. Organic products are a prime example. The government's role is to ensure quality information flows through to consumers by helping producers and the industry establish standards and encourage the development of third party certification and traceability systems that will address this market failure. These standards and certification will also allow Canadian producers to produce and meet international standards for international market access as well. The Canadian government must continue to work with the WTO and international obligations to ensure non-tariff barriers related to SPS standards and regulations promote trade liberalization and not barriers.

Because there will always be smaller producers who will be unable and unwilling to adapt to large retail chain specifications and contracts, there is a role for government in ensuring that there are markets for small producers as well, such as in small, regional, local farmers' markets. In addition, small producers can also develop niche markets for their products. As food retailing continues to evolve in Canada, the government role is to ensure efficient and orderly markets. Both consumers and farmers will benefit from these developments as long as this is assured.

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A close-up, slightly blurred photograph of the Canadian flag, showing the red and white colors and the maple leaf. The flag is positioned diagonally across the frame, with the top left corner of the image showing the flag's edge.

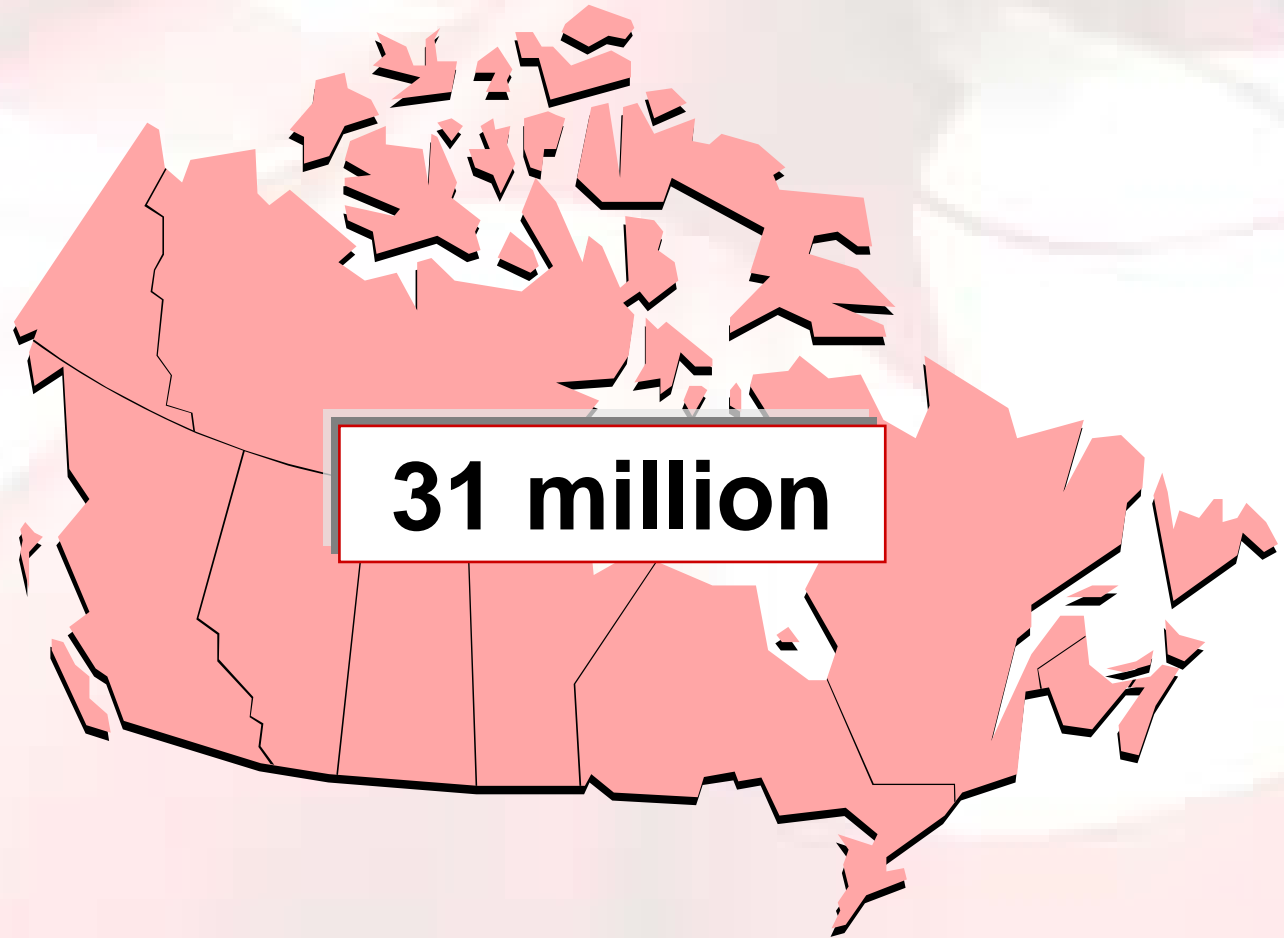
Food Retailing in Canada: Trends, Dynamics and Consequences

Pacific Food System
Outlook Meeting

Margaret Zafiriou
May 10-13, 2005 – Kunming, China

Background – Canada

Canada is a relatively small country...



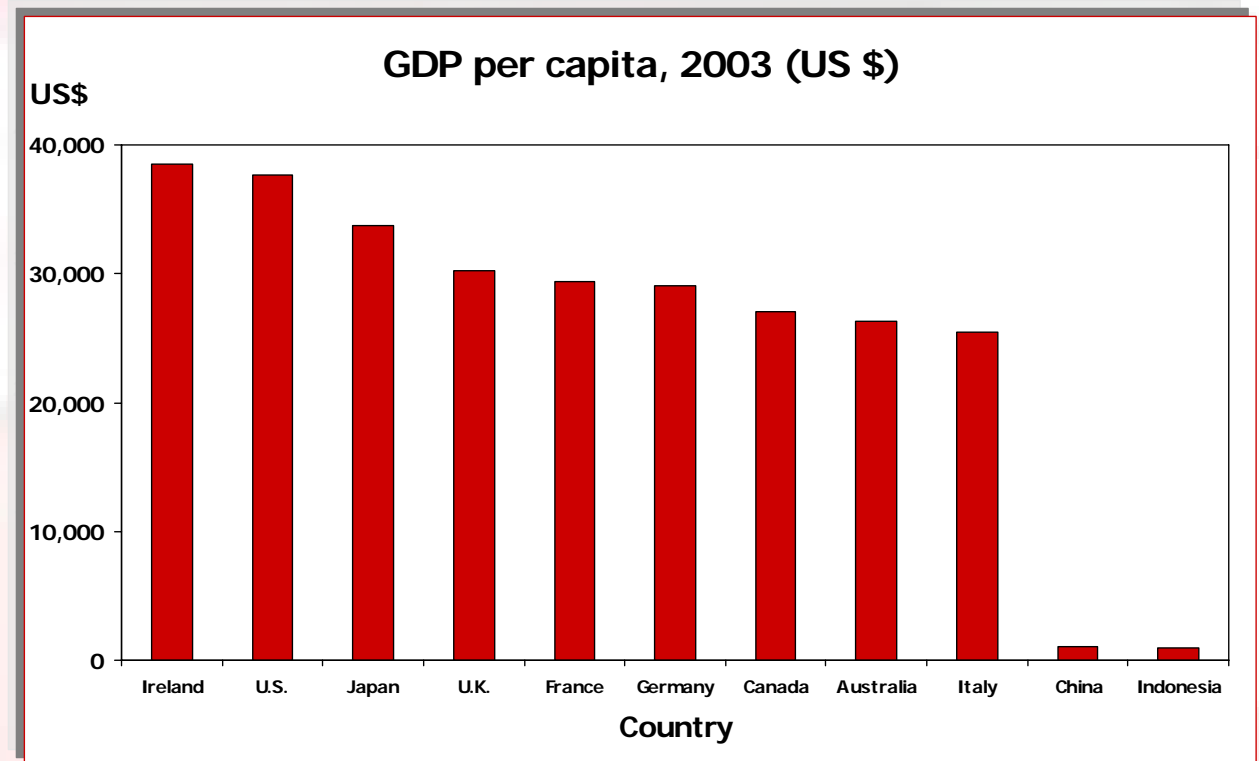
...in terms of population

Food is retailed through several channels including...



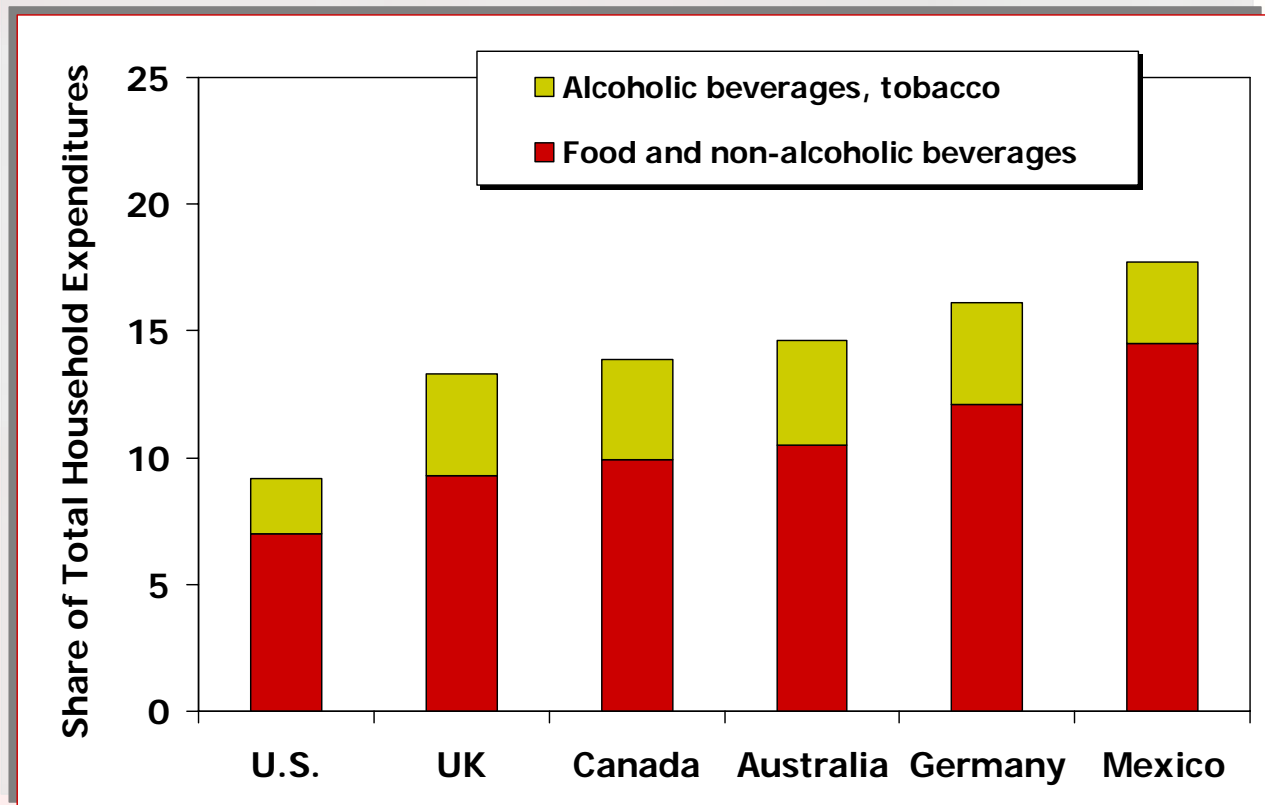
	Percent
Supermarkets (Grocery Stores)	80.1
General Merchandise Stores	9.7
Specialty Food Stores	7.3
Drug Stores	1.4
Gas Station	1.0
Other	0.3

Canada's population is highly educated



...with a relatively high level of income.

Compared to other countries...



...Canadian consumers spend a fair amount on food.

In summary...

- Canadian consumers expect and want:
 - ❖ safe food at a minimum
 - ❖ choice and quality
 - ❖ healthy food options
 - ❖ convenience
 - ❖ exotic varieties
 - and
 - ❖ have the buying power to purchase them

There are three words to describe the state of food retailing in Canada...

- Competition
- Consolidation
- Consumer-driven



This reflects the consolidation that has occurred in the sector...



...just as it has in other countries.

The relative importance of these players is shown by relative sales...

	Billion \$
Loblaws Companies	27
Sobeys Inc.	12
Canada Safeway	5.3
A&P	4.6
Metro Inc.	4.3
Wal-Mart	3.3
Co-ops	3.1
Overwaitea	2.6
Costco Food	1.1
Couche-Tard	0.8
Shopper's Drug Mart	0.7

Loblaws

- Canada's largest grocery retailer
- Canadian owned
- 41% share of national chain market
- market leader
- sales in 2004 of \$27 billion
- moving to restructure supply chains
- cutting costs
- expanding Supercenters
- Increasingly offering non-food products and services

Policy issues

- Competition or Anti-Combines Legislation
- Role of retailers and market power relative to processing and primary agriculture sector
- Food security
- Rural development
- Food and Drug Act (labeling, advertising)
- Regulations for food safety
- Public education (nutrition and health)