GEORGE MORRIS CENTRE

A Tale of Two Categories

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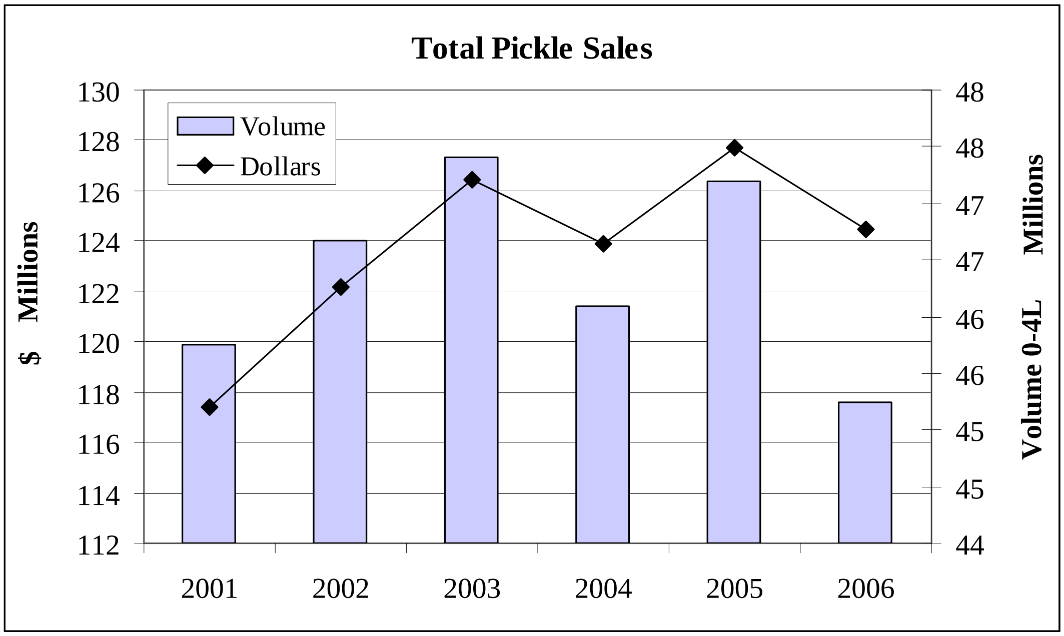
Each category within a grocery store is a unique competitive battleground. Grocers compete with each other for the share of the consumer's dollar that goes to that category. Food manufacturers compete with each other and often with the grocery distributor, for share within the category itself. Each category, therefore, can provide a picture of the competitive ebb and flow that occurs in the industry overall. Furthermore, each category has a role and function to perform within the store. Some categories are traffic builders while others are designed to highlight price positioning, and still others are cash cows.

Even categories that, from the outside, may appear predictable and conventional, in fact can offer interesting lessons and insights into the food industry. The following is a review of two such categories that may have a greater impact than one might realize at first glance. Pickle and Baby Food categories are both seeing new competition from US companies, which will cause competitive ripples both within, and possibly beyond, their respective categories.

Pickles

ACNielsen Canada, Markham, says that "mainline" pickle sales in Canada amounted to about $87.5 million in the 52 weeks ended October 2, 2006. Mainline pickles include dills, bread & butter and sweet mixed pickles. The total pickle category, as defined by ACNielsen, includes the mainline plus specialty pickles (i.e. gherkins, red peppers, beets, hot mixed peppers, sauerkraut, etc.). The total pickle category amounts to about $124-125 million. Mainline sales are down about 2% from the same time last year but up 2% from 2004. The 2006 total sales for pickles are down about 3% from 2005. That modest up and down performance is characteristic of the last few years. The following graph shows total pickle sales for the 52 weeks ending in early October for 2001 to 2006.



Source: ACNielsen, Markham, Ontario

The pickle category is somewhat difficult to categorize. From the consumer perspective, it is neither a staple nor a necessity. The frequency of purchase is comparatively low, but the category has a high household reach. A material share of the purchase of pickles is of a seasonal nature, given that the products are often used for both entertaining and in the barbeque season. Basically, the category has characteristics of fill-in, necessity, and staple combined. Furthermore, a glance at the graph above suggests that the consumer demand for pickles should be characterized as stable or strong, as opposed to stagnant and weak. The rationale for that statement is the fact that, while volumes have eased lower over the past few years, the overall revenues have been mostly increasing on a year to year basis.

From the grocer/distributor's perspective, pickles can again be viewed in different ways. From a product perspective, they are a commodity, like canned goods or sugar. As such, there is only so much a grocer or manufacturer can do, other than pricing, to generate volume or margin. Pickles are not a flagship category that generates big profits and volume, nor are they a core traffic builder that helps to bring people to the store week after week. The category is big enough that it needs to be competitively priced but, at the same time, it is small enough to offer pricing flexibility. While pickle margins are not huge, the margins are good and certainly above average for the grocery department. They generate better margins, largely because the low frequency of purchase means that price sensitivity is less than that for high frequency items. Furthermore, the category is small enough that grocer/distributors have chosen not to use it as a competitive weapon.

Given the storable nature of the product and the fact that it can be easily pantry loaded, according to the marketing 101 textbook neither grocer nor manufacturer should be inclined to want to feature it often. With that noted, however, given the seasonal nature of the product, it is one that can be used as a draw if sharply priced. In that regard, grocers and manufacturers have fallen into the trap of featuring it strongly at times when demand is best. While that might be self-defeating, pickles still outperform the grocery department in terms of margins over the course of the year.

All in all, even though it is a commodity category, it has enough unique characteristics that it does represent both growth and margin opportunities for grocers.

The New Player

Within that context, it is noted that Vlasic Pickles, marketed by Pinnacle Foods Canada, Mississauga, has been in the Canadian market for just two years. Vlasic is the largest selling pickle in the US and obviously took note of the fact that the Canadian market had just one major brand. With the exception of specialty brands, and private label, Bick's, manufactured in Canada and marketed by Smucker's, was the only brand on the shelf. This situation must have looked tempting to the US brand leader.

It is always of interest to assess what happens to a category when a major new competitor enters the market. Depending on the distributor, it appears that Vlasic's share has grown from 0 to 7-10% over the past two years. By most measures, that is an impressive performance. Interestingly, based on the data, it does not appear that much, if any, of the share has been taken from Bick's. According to the ACNielsen data, control label pickle sales have declined from nearly $43 million in 2004 to just $38 million in 2006 (52 week basis), a decline of 12%. This in a category that saw total sales, branded and control, mostly unchanged over that same period. Simple arithmetic, therefore, shows that branded product actually increased materially over the same time frame. This suggests that while Vlasic gained share, Bick's at the very least was holding its own. In addition, overall branded-private label performance stands in contrast to many, if not most, categories in the grocery store.

Vlasic has proven to be a very aggressive competitor. It competes with consumer $1-off coupon promotions, buy-one-get-one promotions, and featuring. Pinnacle has even chosen to sell a large volume version at Wal-Mart for a very low price. At the same time, it has positioned itself as a higher end pickle at grocery stores and is priced $0.40-50 more per litre than Bick's and up to $1.50 more than basic private label. Given that price and image positioning, it is of particular interest that Vlasic's growth has come at the expense of private label. It could mean many things, including the strength of the Bick's brand, the relative weakness of the private label offering and, more importantly, the fact that many private label buyers are not motivated by price.

Why do distributors carry Vlasic and what role does Vlasic play? This is of particular interest in an era in which brand consolidation on the shelves is more the norm. Vlasic needed to show that it was going to be more than a "me too" entry. The first point is that Vlasic proved early that it was going to support the brand with advertising and promotion. It also demonstrated that, with advertising, it could back up a higher price. From the distributor's perspective this higher price has provided greater margins, and is a likely reason why they have tolerated the private label share erosion. The slightly higher-end offering also provides retailers with a broader category spectrum to answer a broader range of consumer demand. In addition, the presence of another well-financed and aggressive brand never hurts to keep the brand leader in line. With a healthy private label presence and a solid secondary brand with aggressive tendencies, there is no doubt that Smucker's will need to be supportive to its brand, and retailer's needs regarding the brand.

Going forward, Smucker's and Pinnacle, as well as the grocery distributors are going to need to reassess their tactics. If Pinnacle brought Vlasic to Canada thinking that they would take the low hanging fruit from Bick's they need to think again. Bick's have proven to be a formidable competitor, once provoked. Furthermore, there have to be questions as to how much more private label share Vlasic can take, and how much the retailer is willing to give up. From the distributor's perspective, there likely is enough reason to review the priorities and attention that the pickle aisle deserves. As a leading profit maker with two solid brands and private label, the category may be underdeveloped and in need of a revamp. At the very least, a new planogram might be in order.

Jarred Baby Food

The jarred baby food category is relatively small but it serves a very well defined and important niche. While the category appears staid and settled from the outside, in fact it is a field of intense competitive rivalry. As of 2006, it began another round of competition that is likely to be played out in 2007.

Background

During the mid-1990's, aggressive competition in the baby food aisle was fought between Gerber Products and H.J. Heinz. In addition to competing in the market place, Heinz decided to take the battle to the realm of Canadian trade law. In 1998, Heinz Canada managed to convince the Canadian International Trade Tribunal (CITT) that dumped or subsidized jarred baby food imports from the US "caused, or were threatening to cause, material injury." Heinz was and is the sole domestic producer of baby food and the targets of the trade challenge were Gerber Products in the US and Gerber Canada. The fact that Heinz was able to show there was dumping was not surprising given the breadth and scope of the definition of dumping. That is, many imported products could be considered to be dumped in the legal sense, given the criteria. The real challenge is to demonstrate injury caused by dumping.

In coming to its 1998 conclusion that dumping by Gerber US had caused material injury to Heinz Canada, the Tribunal found that Heinz Canada had been able to maintain its market share, in a shrinking market, by dropping its net prices significantly. More particularly, the evidence showed how quickly and dramatically market shares could swing from retailer to retailer and from grocery channel to drugstore channel, depending on feature price initiatives by one distribution channel or another. In these circumstances, Heinz Canada had the option of losing volume and market share to Gerber Canada or suffering price erosion.

The Tribunal also noted that Heinz Canada's performance had been affected by, among other things, declining demand for commercially prepared baby foods and negative publicity arising from a then recent study that questioned the quality and nutritional value of Heinz Canada's commercially prepared baby foods. However, after accounting for all these factors, the Tribunal found that the residual effects attributable to dumping by Gerber US still caused injury that was material in magnitude.[1]

The stakes for the industry were huge as a result of the duties imposed on imported Gerber product. Since the finding in 1998, Gerber Canada has ceased to exist as a separate business operation and its sales of baby foods have also stopped. Novartis Consumer Health Canada assumed all responsibilities for the marketing of Gerber US's non-jarred baby food products in Canada. Novartis is related to Gerber US's parent company, Novartis AG Switzerland. From 1998 forward, Heinz essentially became the sole supplier of jarred baby foods, with an overwhelming share of the market. In addition, Heinz was the supplier of one of the main lower end brands, “Simply Kids.”

During the period in which the duties were in place, Heinz behaved just as would be expected in the absence of material competition. According to the CITT analysis, Heinz reduced the number of SKUs offered by almost 25 percent. In addition, wholesale prices were said to have increased on average by just over 6 percent per year since 1998. In 2003 at a review hearing, the Tribunal also heard testimony that Heinz Canada reduced its promotional activities during the period. At that time it was seen to spend considerably less, approximately one third less as a percentage of net sales, than Gerber US spends in the United States. Finally, the Tribunal noted that Heinz Canada has not introduced any significant product innovations within the category of CPBF since the finding.

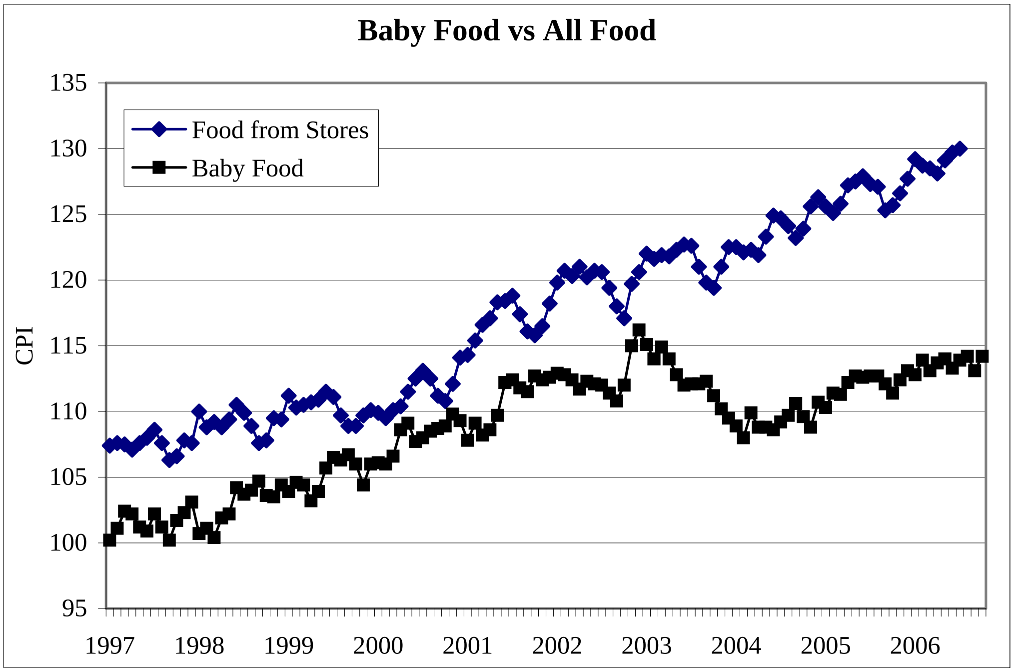
The duties imposed on imported product were slated to expire, or to be up for review, in the spring of 2003. Heinz, of course, complained to the CITT at that time that if the duties were removed it would be injured. Heinz Canada submitted that, if the finding was rescinded, the domestic industry would be materially injured through price undercutting, erosion or suppression, and through lost sales because of the presence of dumped imports. Heinz Canada also argued that recent changes in circumstances made it more vulnerable to injury now than it was at the time of the finding. Of particular note were the following facts: falling or flattening birth rates; longer maternity leave benefits, inducing a shift to more home-made baby foods; the increased presence of mass merchandisers in the market; and a greater concentration of grocery retailers. All these facts affect Heinz Canada's leverage in the marketplace. As well, Heinz Canada's undertaking to the Commissioner of Competition prevents it from entering into long-term or exclusive supply arrangements with customers, a situation which would not be faced by other baby food competitors if they entered the Canadian market.

[1] Expiry Reviews (Section 76.03) Orders and Reasons – Final CERTAIN PREPARED BABY FOODS ORIGINATING IN OR EXPORTED FROM THE UNITED STATES OF AMERICA Expiry Review No. RR-2002-002

In any event, despite the Heinz arguments, the CITT rescinded the findings of 1998 and the Canadian market was effectively open to imports of jarred baby foods once again. As a result, Gerber re-entered the Canadian market in the summer of 2006.

Category Performance

While the wholesale prices of baby food were jumping during the post 1998 period, retail prices were stagnating. The following graph shows the performance of baby food (not just jarred) compared to other foods purchased from grocery stores as indicated by the Consumer Price Index.



As can be seen from the graph, increases in the retail price of baby food have not kept up with the rate of inflation in the total retail food business. It is also worth noting that retail food price increases have significantly lagged that of the total CPI.

Wholesale and retail price performance suggests that baby food is not a profitable category. Recall that CITT said that jarred product rose by 6% each year at wholesale. At the same time, the graph shows that retails rose barely 15% over ten years. That math does not look good for baby foods. The fact is that baby food's gross margins are below that of the overall grocery department. Offerings at retail are often little better than cost.

In terms of sales, according to ACNielsen, Markham, the total baby food category, which includes jarred, toddler, and organics, amounted to about $61 million in the 52 weeks ending in October 2006. In terms of total dollar sales, the category is relatively small. For example, all baby food is about half the size of the ketchup category. Furthermore, that $61 million in sales is down 2% from the previous year. To make matters worse, the dollar sales decline exceeded the 1% tonnage decline, meaning that price erosion at retail is continuing.

While the category is not particularly large or profitable, it does play an important role. Beyond the basic demand for the product, the type of shopper in this category is of great interest to grocers. If shoppers are buying baby food, chances are they are pushing around very full shopping carts. Not only do they have families to feed, but they are more likely only going to make one stop. It is important for the grocer to be that stop, and for that reason the category is critical. These shoppers are the cream of the crop and everyone wants the baby food shopper. That is why grocers stay very competitive with the product and why retail baby food pricing may lag the grocery store as a whole.

Into this environment Gerber has decided to try and re-establish share and brand equity. At first glance, it would appear that this market would be ripe for the taking. After years of Heinz being the main supplier, conventional wisdom suggests that grocery buyers would welcome a well-known, name brand competitor, such as Gerber. Furthermore, it appears that Loblaw decided that Heinz's performance since it held sway in 1998 merited a de-listing. It is now listing Beechnut brand and its own private label in the category. A move away from Heinz to a much lesser known Beechnut brand suggests Loblaw felt the situation merited the risk. Surprisingly, however, Gerber has not been able to rapidly gain share with major retailers. Loblaws, Sobeys and A&P continue to list Beechnut, Heinz and Heinz respectively. For its part, Wal-Mart is listing both Heinz and Gerber.

Part of the challenge for Gerber, ironically, is that over the last seven years, grocers have either grown comfortable with Heinz or perhaps, in the case of Loblaw, are trying to put their own private label front and centre. While Gerber has strong name recognition and reputation, the Heinz brand is also a comfort brand. Perhaps most importantly, the Gerber brand comes with strings attached in the sense that grocers must take all SKU lines. In other words, Gerber has said take all products in our line-up or none. For now, the leading grocers have opted for the latter. The all or nothing approach does not sit well. Furthermore, and perhaps most importantly, Gerber's costing has been more than Heinz. Not only that, but the company does not appear to be interested in starting any promotional or pricing battles. It is not going to stir things up so early.

The bottom line for the category is that there has not been significant change yet as a result of Gerber's re-entry. The category is small, however, and Gerber cannot be expected to be content with a small share of a small category. Expect the category to heat up in 2007.

Articles discussing pickles and baby food first appeared in the November and January issues of the George Morris Centre publication Grocery Trade Review. If you are interested in a free two month trial subscription to Grocery Trade Review, please e-mail Pat Dares at pat@georgemorris.org, or visit our website at www.georgemorris.org