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Canadian Retailers Competing for the Consumer's Food Dollar

by Guillaume Dubé

Distributive Trades Division
11th Floor, Jean Talon Building, Ottawa, K1A 0T6

Telephone: 1 800 263-1136



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Guillaume Dubé

Review Committee: Philip Cross, Richard Evans, John Flanders and Serge Grenier

Special contribution: Norman Fyfe and Serge Grenier

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Managing Editor: Yvan Gervais

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National inquiries line: 1 800 263-1136

E-Mail inquiries: analysisinbrief-analyseenbref@statcan.ca

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Canadian Retailers Competing for the Consumer's Food Dollar

Guillaume Dubé, Distributive Trades Division

Summary

Not so long ago, *doing your groceries* meant just one thing: *going to the supermarket*. Not anymore.

General merchandise stores are now competing with food stores on their own territory by selling food. This phenomenon has strengthened and expanded over the past few years with the entry of new discount general merchandise stores that sell a wider range of food products. As a result, two major types of retailers are in face-to-face competition for the consumer's food dollar.

How have Canadian grocers fared in this competition? Does our situation differ from that in the United States?

This study shows that Canadian grocers are holding their own, and are doing much better than their American counterparts. Canadian food stores still have the lion's share of consumer spending on food. South of the border, American grocers have been losing ground to general merchandise stores.

The tendency for consumers to shop in only one store is much less popular on this side of the border. Canadian consumers don't get their groceries in general merchandise stores as much as their American counterparts. Canadian consumers get groceries in food stores and general merchandises in general merchandise stores.

Food stores in Canada diversified their offering of food products to reflect new trends in consumer taste. Many sell goods such as TV sets, medication, mattresses and so on, but they have mostly gained market share in health and personal products.

The commercial strategy in the two countries appears to be quite different. In fact, in United States, general merchandise stores invested heavily, while in Canada, it was the food stores that invested the most.

Canadian food stores have improved their share of overall retail profits. Their diversification into a wider range of products and increased investment in their stores seem to have contributed to the improved performance of both their sales and profitability.

This study examines retail sales and profitability by type of store from 1997 to 2004. It focuses on the competition for food and non-alcoholic beverages between food and beverages stores and general merchandise stores. It also compares the relative situation of these two types of stores in both Canada and the United States.

Definitions

A **trade group** (TG) is a special aggregation of retail stores classified according to the North American Industry Classification System.

The expression "**food stores**" is used to designate a cluster of three TGs. Food stores include supermarkets (TG 90), convenience and speciality food stores (TG 100), and beer, wine and liquor stores (TG 110).

General merchandise stores include department stores (TG 170) and other general merchandise stores (TG 180).

All other sectors combined refers to the automotive sector—new car dealers (TG 010), used and recreational motor vehicle and parts dealers (TG 020), and gasoline stations (TG 130); furniture (TG 030), home furnishing (TG 040), computer and software (TG 050), and home electronic and appliance stores (TG 060); building and outdoor home supplies stores, including home centres, hardware stores (TG 070), and specialized building materials and garden stores (TG 080); pharmacies and personal care stores (TG 120); clothing stores (TG 140), and shoe, clothing accessories and jewellery stores (TG 150); and miscellaneous retailers that include sporting goods, hobby, music (TG 160) and book stores and miscellaneous store retailers (TG 190).

Food sales correspond to the total sales of fresh meat and poultry, fresh fish and other seafood, fresh fruits and vegetables, dairy products and eggs, bakery products (homemade and commercial), candy, confectionary and other snack foods, deli, salad bar and prepared foods for take-out, frozen foods and all other food products, as well as soft drinks, alcoholic and other non-alcoholic beverages. However, sales of alcoholic beverages were excluded from the total merchandise sold in the food store sector (TGs 90, 100, 110) in order to better reflect the main activity of this sector.

Canadian grocers go one better than their American counterparts

Many more Canadians buy their groceries in food stores than do Americans. Moreover, Canadian food stores have kept the lion's share of the food sales market, as opposed to what has happened in the United States.

In 2004, Canadian consumers spent \$61.6 billion on food. For every \$100.00 of this spending, consumers spent \$83.90 in food stores, practically unchanged from \$85.10 in 1998. They spent only \$10.60 on food in general merchandise stores, up only slightly from \$9.00 in 1998.

Since 1998, food sales have accounted for about 15% of total sales in general merchandise stores.

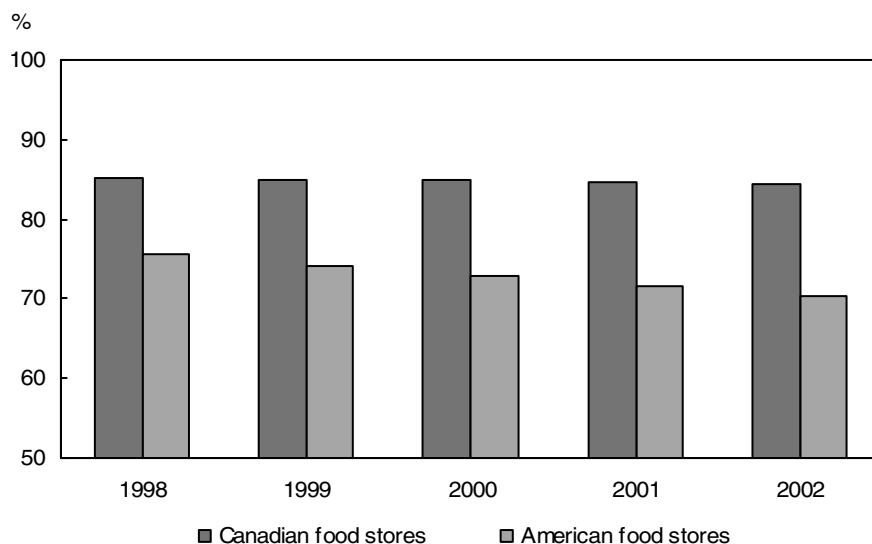
In contrast, for every \$100.00 American consumers spent on food in 2002, just \$70.40 went to food stores, down from \$76.90 in 1997. This loss was made up by American general merchandise stores, which had one-third of all food sales in 2004,¹ up from an estimated fifth in 2002.

In other words, these estimates reveal that American consumers spent three times the proportion on food in general merchandise stores than Canadian consumers in 2004.

1. See Art Turock, "Who Says You Can't Compete With Wal-Mart?" *Canadian Grocer*, February 2005, pages 50-51, 53, 55, 57 and 59.

Food sales represented 19.8% of total sales in American general merchandise stores in 2002, a substantial increase from only 14.4% five years earlier.² The value of food sales for general merchandisers rose six times faster than it did for food stores during this period.

Canadian food retailers have kept the lion's share of the food sales market, unlike their American counterparts



Source: Statistics Canada, Quarterly Retail Commodity Survey and US Census Bureau, Economic Census.

Distribution of selected merchandise group sales by trade group sectors, Canada, 1998 to 2004

| Merchandise groups | Food stores | | | General merchandise stores | | | All other sectors | | | Retail trade total | | |
|--|--------------|--------------|----------------------|----------------------------|--------------|----------------------|-------------------|--------------|----------------------|--------------------|--------------|----------------------|
| | 1998 | 2004 | 1998 to 2004 | 1998 | 2004 | 1998 to 2004 | 1998 | 2004 | 1998 to 2004 | 1998 | 2004 | 1998 to 2004 |
| | % | | % point ¹ | % | | % point ¹ | % | | % point ¹ | % | | % point ¹ |
| | | | | | | | | | | | | |
| Food and beverages | 82.2 | 77.0 | -5.2 | 14.3 | 15.2 | 0.9 | 1.9 | 1.5 | -0.3 | 20.7 | 18.5 | -2.1 |
| Health products and personal care | 5.0 | 7.3 | 2.3 | 7.8 | 10.9 | 3.2 | 8.6 | 8.8 | 0.2 | 7.8 | 8.8 | 1.1 |
| Other non-food products | 12.8 | 15.7 | 2.8 | 77.9 | 73.9 | -4.1 | 89.5 | 89.6 | 0.1 | 71.6 | 72.7 | 1.1 |
| Merchandise group total² | 100.0 | 100.0 | ... | 100.0 | 100.0 | ... | 100.0 | 100.0 | ... | 100.0 | 100.0 | ... |

... not applicable

1. The variation between 1998 and 2004 might differ from the number presented in this column due to rounding.

2. Components might not add up to the total due to rounding.

Source: Statistics Canada, Retail Commodity Quarterly Survey.

2. US Census Bureau, *1997 and 2002 Economic Census: Retail Trade United States*, available at <http://www.census.gov>, accessed on August 31 2005, last update on February 19, 2004.

Canadian food stores have diversified

Canadian food stores have responded well to changes in consumer preferences. Food products have diversified to satisfy the new living patterns of Canadians. Canadian food stores also offer non-food items.

Sales of deli, salad bar and prepared foods for take-out grew 6.6% per year between 1998 and 2004. Frozen food sales also rose quickly (+5.9%). These two merchandise groups helped the annual growth rate of food sales increase from 2.6% in 1998 to 3.0% in 2004.

Demand for these products has grown because of, among other things, the rapid growth of the participation rate of women with preschool-aged children in the labour force (up 1.0 percentage point per year since 2000) after it stagnated in the 1990s. Sales of household goods such as microwave ovens, also rose quickly, reflecting 1.0% more households per year.

In order to keep their clientele, Canadian food retailers have been offering more non-food items than American retailers. Between 1998 and 2004, the proportion of non-food sales in all food stores rose 5.1 percentage points in Canada. This growth is nearly five times the 1.1 percentage point increase in the United States. Non-food sales consist primarily of necessities, such as health and personal care items. Sales of these items jumped more than 10% a year, which reduced the market share of other retailers.

In Canada, food stores increased their market share of sales of health and personal care items from 13.9% in 1998 to 16.8% in 2004. Food stores had the biggest gains in market share for medication (prescription and over-the-counter), vitamins, medicinal plants and other health supplements (10.3% of total sales in 1998 to 14.1% in 2004). These gains are partly due to more supermarkets with pharmacies as well as increased consumption of drugs. Food stores sold proportionally more of these health items than general merchandise stores.

Distribution of major merchandise group sales by trade group sectors, Canada, 1998 and 2004

| Merchandise groups | Food stores | | | General merchandise stores | | | All other sectors | | |
|--|-------------|-------------|----------------------|----------------------------|-------------|----------------------|-------------------|-------------|----------------------|
| | 1998 | 2004 | 1998 to 2004 | 1998 | 2004 | 1998 to 2004 | 1998 | 2004 | 1998 to 2004 |
| | % | % | % point ¹ | % | % | % point ¹ | % | % | % point ¹ |
| Food and non-alcoholic beverages | 85.1 | 83.9 | -1.2 | 9.0 | 10.6 | 1.6 | 5.9 | 5.5 | -0.4 |
| Health products and personal care | 13.9 | 16.8 | 2.9 | 13.1 | 16.1 | 3.0 | 73.0 | 67.1 | -5.9 |
| Household products and supplies | 29.0 | 29.9 | 0.9 | 40.8 | 42.0 | 1.1 | 30.1 | 28.1 | -2.0 |
| Garden products and hardware | 1.9 | 3.0 | 1.1 | 16.1 | 14.9 | -1.2 | 82.0 | 82.1 | 0.1 |
| Sporting and leisure equipment | 5.7 | 6.2 | 0.5 | 28.9 | 32.7 | 3.9 | 65.5 | 61.1 | -4.3 |
| Tobacco products and supplies | 44.7 | 42.9 | -1.9 | 18.4 | 22.8 | 4.4 | 36.9 | 34.4 | -2.5 |
| All other goods and services | 1.2 | 1.6 | 0.4 | 11.9 | 10.2 | -1.7 | 86.9 | 88.2 | 1.3 |
| Total of goods and services² | 21.4 | 20.2 | -1.2 | 13.1 | 13.0 | -0.1 | 65.5 | 66.9 | 1.3 |

1. The variation between 1998 and 2004 might differ from the number presented in this column due to rounding.

2. Components might not add up to the total due to rounding.

Source: Statistics Canada, Retail Trade Commodity Quarterly Survey.

In 2004, prescription and over-the-counter medication represented most of the sales of health and personal care items in food stores (53.9%), followed by toiletries and personal care items (excluding cosmetics and perfume) at 42.9%. In 1998, the situation was reversed.

Food stores also increased their market shares of lawn and garden products, equipment and plants, and cut flowers, which rose from 9.3% in 1998 to 13.6% in 2004. Sales by hardware and lawn and garden products have on average risen 16.1% per year since 1998. Sales of lawn, garden and patio furniture in food stores saw one of the biggest annual increases (+41.0%) of all merchandise sales.

Sales of food stores by major merchandise groups, Canada, 1998 and 2004

| Merchandise groups | 1998 | 2004 | 1998 to 2004 | Compounded annual growth rate |
|-----------------------------------|---------------|---------------|---------------|-------------------------------|
| | \$ millions | | | % |
| Garden products and hardware | 286 | 698 | 412 | 16.1 |
| Health products and personal care | 2,650 | 4,921 | 2,271 | 10.9 |
| All other goods and services | 1,724 | 3,074 | 1,350 | 10.1 |
| Household products and supplies | 1,468 | 2,180 | 712 | 6.8 |
| Tobacco products and supplies | 2,709 | 3,790 | 1,081 | 5.8 |
| Sporting and leisure equipment | 561 | 758 | 197 | 5.2 |
| Food and non-alcoholic beverages | 43,263 | 51,638 | 8,375 | 3.0 |
| Goods and services total | 52,661 | 67,060 | 14,399 | 4.1 |

Source: Statistics Canada, Retail Commodity Quarterly Survey.

Food stores kept their slice of the pie

Not all food retailers have adopted the same strategy, but overall, the move to more diversified products lines seem to have been profitable for this industry. The profitability of food stores rose over the last four years. Revenues also strengthened, as did operating profits. As well, food stores exercised tighter control over the cost of their merchandise.

Despite general merchandise stores entering the food sales market, food stores increased their share of profits generated in the retail sector.

For every \$100.00 of total retail profits in 2004, food stores gained the second largest part at \$15.40, followed by general merchandise stores at \$11.60. By comparison, their shares in 2000 were \$12.20 and \$10.10, respectively. In other words, the share of profits going to food stores rose \$3.20, twice the \$1.50 increase for general merchandise between 2000 and 2004.

Food stores grabbed \$3.12 billion of profits in 2004, up 14.6% since 2000. By comparison, general merchandisers increased profits 12.0% since 2000, to \$2.36 billion in 2004.

Other measures of profitability are important to understand the financial state of these industries. The operating profit ratio³ reflects the efficiency of the financial structure, by showing how many cents are earned from each dollar of revenue. The gross margin ratio⁴ presents the success firms have had in controlling operating costs.

The operating profit ratio of food stores stood at 4.3% in 2004, up 1.6 percentage points from 2000. Moreover, food stores saw their gross margin ratio increase. It improved from 23.3% to 24.6%, demonstrating food stores had better control over their operating costs.

Food stores generally maintained their market shares in food sales, where gross margins were low but volumes were high. They also succeeded in moving up in the sale of essential health and personal care items, which had higher gross margins and turnover.

The gross margin ratio for general merchandise stores fell. This ratio shows the percentage of operating revenue remaining after subtracting the cost of goods sold. In 2004, this ratio was 26.6%, compared with 27.0% in 2000. This is probably because general merchandise stores tried to increase their share in a market, food, where gross margin ratios are lower (food stores posted some of the lowest gross margin ratios in all retail trade).⁵

Financial statistics by trade group sectors, Canada, 2000 and 2004

| | | Food stores | General merchandise stores | All other sectors | Retail trade total |
|---|-------------|-------------|----------------------------|-------------------|--------------------|
| | | \$ millions | | | |
| Total operating revenues | 2004 | 72,344 | 42,339 | 256,028 | 370,711 |
| | 2000 | 62,683 | 35,245 | 212,269 | 310,196 |
| Gross margins | 2004 | 17,819 | 11,278 | 68,010 | 97,107 |
| | 2000 | 14,581 | 9,517 | 55,401 | 79,498 |
| Operating profits | 2004 | 3,120 | 2,358 | 14,809 | 20,287 |
| | 2000 | 1,807 | 1,500 | 11,548 | 14,855 |
| | | % | | | |
| Gross margin ratio | 2004 | 24.6 | 26.6 | 26.6 | 26.2 |
| | 2000 | 23.3 | 27.0 | 26.1 | 25.6 |
| Operating profit ratio | 2004 | 4.3 | 5.6 | 5.8 | 5.5 |
| | 2000 | 2.9 | 4.3 | 5.4 | 4.8 |
| Share of total operating profits | 2004 | 15.4 | 11.6 | 73.0 | 100.0 |
| | 2000 | 12.2 | 10.1 | 77.7 | 100.0 |

Source: Statistics Canada, Annual Retail Stores Survey and Annual Retail Chain Survey.

3. The operating profit ratio is obtained by dividing operating profits by total operating revenues.

4. The gross margin ratio is calculated by dividing the gross margin by the total operating revenue. The gross margin is the difference between the total operating revenue and the cost of the goods sold.

5. Following changes to the concepts, classification system and methodology, the comparable data for these surveys are only available from 1999. The 2004 data have not yet been released. For more information, consult http://www.statcan.ca/english/sdds/document/2446_D5_T9_V1_E.pdf.

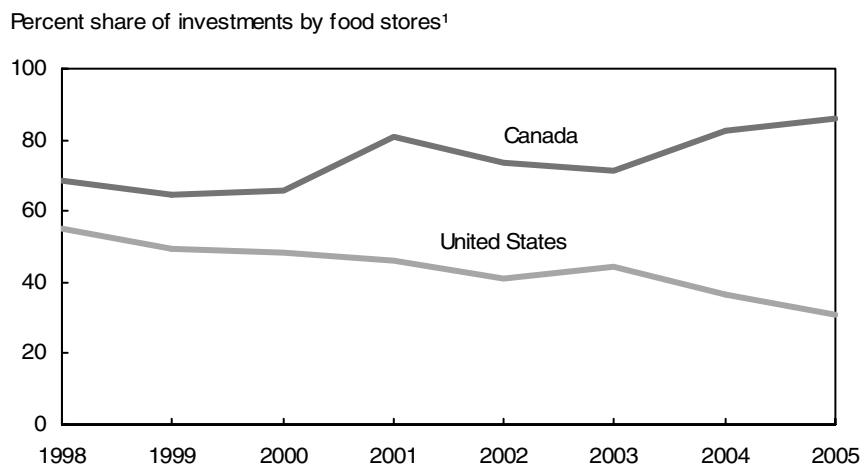
Investment in food stores is higher in Canada

One possible reason why Canadian food stores were more successful is that food stores invested more in their buildings than general merchandise stores. The reverse happened in the United States.

In Canada, food stores spent \$1.1 billion in commercial buildings in 2005, while general merchandise stores spent \$189 million. In other words, food stores explain 85.8% of the investment in these two sectors.

US general merchandise stores invested US\$7.5 billion (69.3% of the total) in commercial building construction while food stores invested US\$3.3 billion (30.7% of the total).

Food stores investment in building construction is much stronger in Canada than in the United States



1. These shares represent the percentage of total investment in commercial buildings (food and general merchandise stores combined) by food stores.

Source: Statistics Canada, CANSIM Table 031-0002 and US Census Bureau, Manufacturing, Mining, and Construction Statistics (Construction Spending).

Investment by retailers grew faster initially in the United States than in Canada, as demand was more robust in the 1990s. Consumption in Canada during this period was curbed by the long recession and the growth of cross-border shopping.

Canada had to wait until the 2000s to see investment by retailers increase rapidly, thanks to sustained growth in consumer spending and a declining dollar that kept Canadian consumers at

home. This trend continued with the additional restrictions on border crossings imposed following September 11, 2001, in spite of the soaring loonie.⁶

In addition, the commercial strategy put forward by some general merchandisers was different in Canada than in the United States.⁷

Food purchases remain robust

Canadian food retailers can count on a continued large role of food spending in consumer budgets.

The proportion of households spending devoted to food remained high at 11.1%, which is almost the same as five years earlier (11.5%). Households allotted an average of \$6,800 for food in 2003, compared to \$5,900 in 1998.

Moreover, Canadian consumers recently stopped spending relatively more money in restaurants after decades of increases. In 2003, households devoted 77.6% of their food expenses to food purchased from stores, compared with 21.9% for food purchased from restaurants, similar to their shares in 1998. In the 1980s and 1990s, spending in restaurants rose much faster than in food stores.

Furthermore, the price of food purchased from stores stayed in line with the general cost of living. The consumer price index for food purchased from stores rose at an annual average rate of 2.1% between 1998 and 2004, compared with 2.3% for the entire index. This has helped to sustain the growth of food store earnings.

Food stores also benefit from the fact that, except for some articles like candies and munchies, food sales are spread over the course of a year. This ensures steady receipts and could allow food stores to make profitable use of their labour and offer better working conditions. In fact, the holiday season has only a slightly higher share of sales than during the other three seasons. In some sectors, the holiday season generates practically the entire year's earnings. Food spending therefore has little seasonality compared to the rest of retail trade.

6. See Francine Roy, "The Soaring Loonie and International Travel," *Canadian Economic Observer*, February 2005, Statistics Canada Catalogue no. 11-010, can be accessed at <http://www.statcan.ca/english/ads/11-010-XPB/pdf/feb05.pdf>.

7. For example, since the early 1990s, Wal-Mart's corporate strategy in the United States has been focused on the construction of "supercentres" that sell general merchandise as well as food. In contrast, it was only recently that Wal-Mart planned to open supercentres in Canada, particularly in the Toronto area. Wal-Mart came to Canada in 1994 after purchasing Woolco, and was more oriented toward general merchandise than food. See Tom Graff and Jim Simmons, *Wal-Mart Comes to Canada*, Centre for the study of commercial activity, Ryerson University, Research Report, 1998–1999, 19 pages, and Bryan Dunn, « *Wal-Mart faces challenge in Canada* », *Supermarket News*, January 2nd, 2006.