Pathways to the market

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1. Introduction

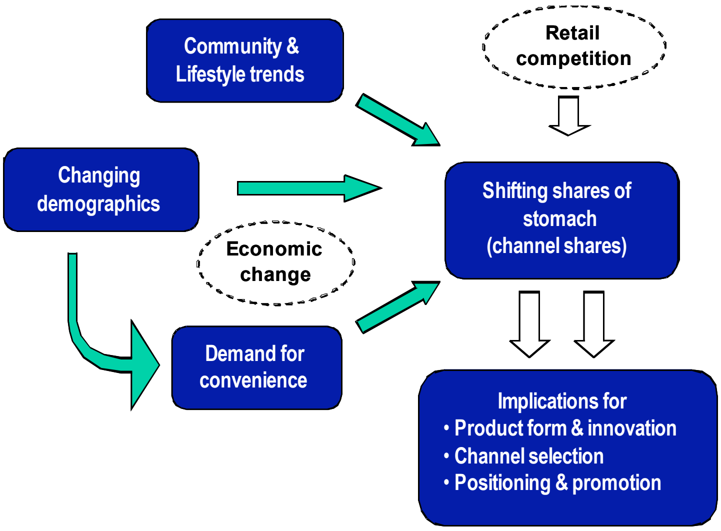
The domestic food market is highly competitive environment that is constantly evolving as consumer preferences become more complex and the strategies of retailers and foodservice operators shift focus.

While the retail food market is concentrated in the grocery retail channel, steady change in shopper and consumer habits trends has led to a greater "share of stomach" being won in the pathways to the market which are outside the large grocery retail format

On the whole, the our assessment reflects a food industry that is undergoing significant challenge, yet finds vastly different conditions and approaches at a category level to respond to challenge and opportunity.

The challenge for food suppliers, manufacturers and brand owners is knowing where to invest – what positioning, what distribution infrastructure and partnerships and where to innovate in process, product, and marketing.

Fig 1 – Influencers of change in the domestic food market

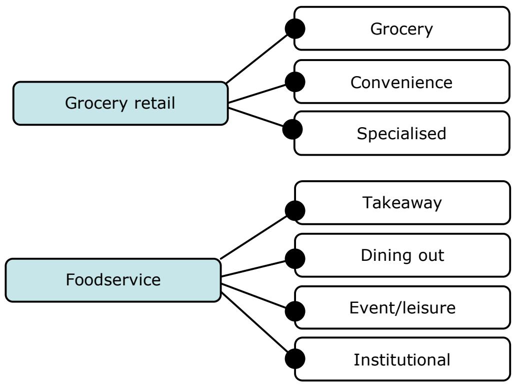


2. The food industry landscape

The food industry landscape can be characterised as follows:

- Total food sales growth was 8.7% in calendar 2007, which compares with an average of 6.4% per annum over the past 3 years
- Two major groups of end markets – grocery retail (through a wide variety of formats) to service food taken home for meal preparation; and food service that caters for food eaten away from the home
- There is a dominant influence of the grocery format and distribution channels by major chain retailers, but there is a rapidly strengthening independent sector as well as fresh and gourmet food specialists that play important roles.
- There are a plethora of foodservice outlets across a diverse number of channels, but making up less than about a third half total food and beverage spending
- A takeaway food channel that is growing faster but comprised of a number of fast growing Quick Serve Restaurant chains and other fast-casual franchises

Fig 2 – Sectors of the consumer market

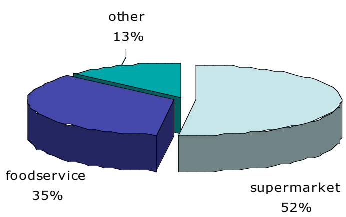


Share of stomach

Rather than talk about simply the share of the grocery market, we should be thinking about "share of stomach" or the share of the consumer's spend on meals and drinks.

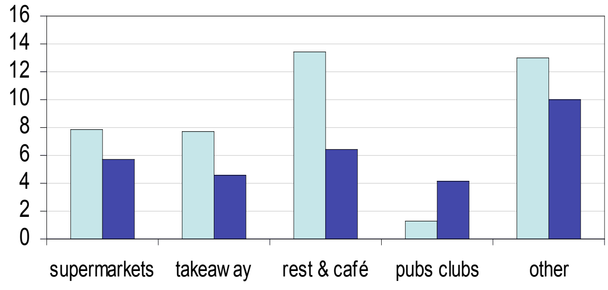
Major full service supermarkets dominate the grocery channel.

Fig 3 - Spending by channel per ABS data in 2007



Getting a fix on the numbers is not easy – you can just about define market shares any way you want, and there are a number of variations that exist depending upon whether the analysis relates to food, total supermarket volume and food & liquor. Taking the wider definition when you consider the contest for the share of stomach and the channels to the consumer are far less concentrated and becoming more diverse as other channels strengthen in better suiting consumer lifestyle and convenience trends. The actual market for food consumed outside the home is likely to be larger than what ABS analysis used in Fig 3 suggests.

Fig 4 - Spending by channel per ABS data – % increase in 2007 and over last 3 years



This is due to:

- ☒ Supermarkets and specialty retailers (included in "Other Retail" sales) supplying food and beverages to takeaway and dining out outlets
- ☒ The size of the institutional food market, where much of the sales value of food consumed in health care, defence and other channels is not recorded as a retail food sale
- ☒ Food consumed with beverages in cafés & restaurants, pubs and clubs.

Of course, the share of volume going into each sub-channel is vastly different and impossible for a public sector agency to measure. In reality however the true numbers for the share of spend suggest the gap is closing. In the US, where foodservice is further advanced in consolidation and consumer trends have more quickly taken more food out of the home kitchen, analysts estimate that shares of spend will be equal within 5 years.

FOODMap

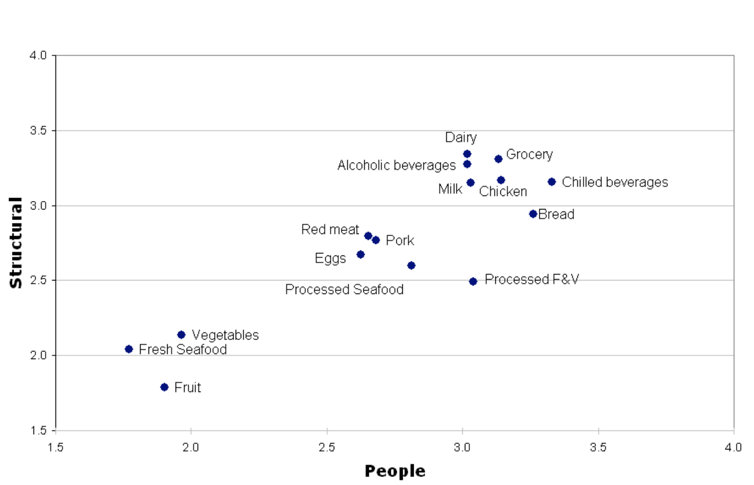
A key challenge was recognised in the development of FOODmap in 2007 as a guide to the structure of food distribution channels to the consumer. It also provided a guide to the relative potential for different categories and channels to enable creation and capturing of value by suppliers.

The core part of the FOODmap package provides the food industry with a mapping of the supply of major food categories to channels and sub-channels of the consumer market. This analysis has been conducted from two directions to provide an effective understanding of the structure of food distribution in the food industry:

- ☒ Where the food goes
- ☒ How the last point of sale to the consumer is serviced

The analysis in this report has included a number of "point in time" comparative measures of each value chain's ability to create and capture value. This is performed using a number of criteria to evaluate each food category under six headings as set out in the table to the right, which have been used in Freshlogic's value chain assessment tool.

Fig 5 – The comparative assessments of value chains



The criteria used in this comparative assessment include factors that relate to:

People factors (x axis)

- ☒ Whether you may be dealing in an informed market or not
- ☒ The demonstrated scope for innovation
- ☒ Whether value is recognised and captured

Structural factors (y axis)

- ☒ The apparent diversity of products and services
- ☒ The primary product yield
- ☒ The apparent logistical efficiency in the value chain

This gives us a relative assessment of different categories. Not all conditions will be such as that, but it is a guide to opportunities and dangers. The assessments are generalised, taking account of the overall tendency in each case. At a detailed level within each food category and distribution channel there will be examples which differ significantly to the general conditions in each case, where niches and better added-value are being witnessed.

3. What is driving change and where?

The consumer

Steady change is influencing what consumers want and how they get it. These changes are especially new, but the way in which retailers respond – or don't – and the approaches being taken to take advantage of the shifting ground is important for every food supplier to think about.

Shapers of choice:

- ☒ *Household structures changing – childless couples, single adult households, one parent families*
- ☒ *Work-life mobility and balance*
- ☒ *Smaller homes*
- ☒ *More complex wants and desires*
- ☒ *Changing income levels and sensitivity*
- ☒ *Greater ethical concern*
- ☒ *Health aspirations*
- ☒ *Aging population*

Insights from **Mealpulse™ ***

- *Lifestyle & household structure drive eating out frequency/convenience*
- *Wide variation between segments in % of spend on meals out of the home*
- *Breakfast& coffee are fastest growing occasions*
- *Increasing use of specialists alongside supermarkets in bread, meat, fruit & vegetables*
- *Greengrocer catching most shoppers, butcher landing the highest spend*

Changes in preference:

- ☒ *Break down of meal times*
- ☒ *Shorter time given to preparing and eating food*
- ☒ *Greater time given to commuting - leisure must compensate*
- ☒ *Less planning, more eating on the go*
- ☒ *Affluence affords investment in lifestyle through fitness and diet*
- ☒ *Demand for smaller portions & managed nutritional fix*

Which shows up in:

- ☒ *Focus on "occasion" rather than food*
- ☒ *More diverse options sought for eating away from the home*
- ☒ *Greater demand for fast-casual dining*
- ☒ *Increasing incursion of "take-away" into meals that present a healthy option*
- ☒ *Shopping trip purposes are changing*
    - *Top-up v tonight's meal v pantry fill*
- ☒ *More diverse scope for "premium"*
- ☒ *Greater commoditisation of staple lines into private label*

Over time, these significant forces will continue to shape the requirements and opportunities for retailers as well as fresh and processed food suppliers. Analysis indicates that sales of food into the foodservice sector will continue to grow faster than conventional grocery retail channels.

* Freshlogic's consumer panel that draws insights on decisions influencing meal occasions

The influences on channels

So what are we seeing as a result of this?

Grocery retailers

- ☒ Same store sales have been hard to grow at rates faster than food inflation – as seen in Fig 7, same store sales show the contrasting tale of retailer performance, yet in aggregate
- ☒ Tighter category management – rationalising brands to performers, yet demanding innovation
- ☒ Stronger independents – better banner presence, improving buying and logistics
- ☒ Localised product ranging and promotion
- ☒ Retailer diversity – other categories and formats to gain greater access to consumer spend
- ☒ Greater attention to points of difference that critical mass can offer the consumer through the ethical values of the retail format (energy consumption and waste reduction) and product offering (origin, ingredients and soon carbon-rating)

Other channels

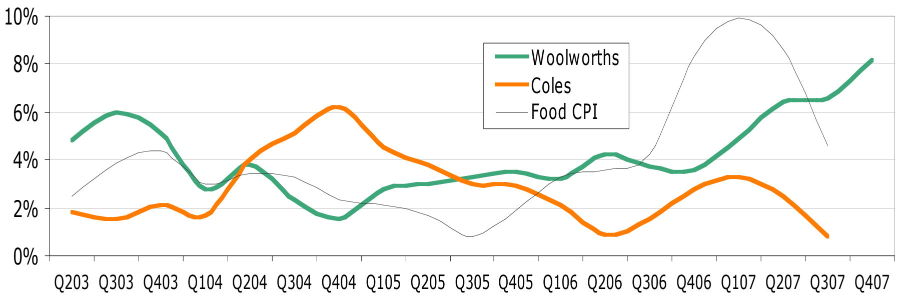
- ☒ Stronger specialists – well-positioned, attentive butcher, baker, green grocer offers
- ☒ Niches building their place – organics through specific retail format or dedicated shelf-space
- ☒ Consolidating foodservice distribution sector,

Food service specialists

- ☒ Refreshment and expansion of menus (Subway's healthy salads led others, McDonalds largest fresh salads and coffee retailer)
- ☒ Improvement in efficiency of drive-thru (60% of McDonalds sales)
- ☒ Expanding eat-on-the-go franchises, capitalising on shopper and commuter traffic
- ☒ Growth in the institutional management of food by professional solution providers (contract caterers)

The pressures of performance and increasing competition being placed on the major retail chains will continue to compel those businesses to streamline costs and drive category performance. This will be done in existing supermarket networks, by selectively adding and refurbishing stores where the demographic and locational opportunities exist, alongside expansion of their retail format into new categories that tap into everyday consumer spending, such as fuel, liquor, office, pharmacy, and others lent from overseas experience.

Fig 7 - Retailer same store sales v food price inflation



This brings opportunity for food suppliers into a wide variety of distribution channels many of which are growing at rates faster than the average being achieved by the total food market. At the same time however the diversity also presents challenges in assessing and managing the complex range of determinants of volume and value in each channel and sub-channel of the retail food market.

The challenge for food suppliers is to understand and evaluate the significance and longevity of trends that may affect consumer shopping and eating choices – and its impact on product and promotional investment

Overcoming a fixation?

One of the enormous challenges facing food suppliers themselves is overcoming an exposure to being fixated with "major grocery".

There'll be yet another revival of the public debate about the extent and the effects of "supermarket dominance" in the coming months as the ACCC works through its wide-ranging brief in the review of the competition in the grocery market. There is little doubt that, for many, the dominance of the major supermarket format and supply chain structure is significant, via:

- The blanket access to the consumer
- Existing share of fresh and packaged grocery product markets
- Suppliers which have hard-wired their business processes to meet supply chain and product specifications
- The extent of advertising and promotion in the face of the consumer – especially in fresh food – fruit & vegetables, meat, dairy, bakery – where the promotional investment by retailers creates a perception of value to the consumer
- The expansion of use of private label - through "tiers of value" and width of coverage - on category value and growth
- The behaviour in pricing and buying
- Focus on supply chain costs - The pressures on performance has driven a strong focus on reduction of costs of supply, and greater onus on suppliers to balance supply and demand.

Visibility

The grocery retail market is well serviced with expensive scan-data information and analysis that allows ready recognition of the changes occurring in volume and value through that channel. The foodservice sector of the food industry on the other hand is very poorly serviced with information.

As a result of the lack of ready information, many food service and convenience channels remain below the radar for food suppliers:

- There is poor visibility of the value of channels through to the end consumer. Not only is there generally limited information, there is in many instances a strong influence of distributors which do not channel data back up to their suppliers, as well as the strong role played by "route" in some categories
- The sheer complexity of distribution channels servicing some sectors prevents ready guess-work on not only the size of the end market but more importantly where the value is added and who actually owns and influences the customer relationships
- As a result, the channels are often destined to operate under commodity conditions – foodservice is frequently treated as a "dumping ground" by major suppliers to soak up capacity

The food sector is under increasing competitive pressure from commodity imports in fresh and processed products. This will ultimately take a greater share of available foodservice opportunities.

Food businesses can protect themselves by understanding the local market better, by tailoring how they cater for and build sustainable relationships, and by overcoming barriers to commoditisation. Without better knowledge of the size of the market and product opportunities and threats, many suppliers will continue to treat foodservice channels as "residual" markets.

4. Where does upside exist?

Our work in the development of FOODmap identifies that opportunities for the food industry to improve performance and capture value are based on four major themes:

a) Innovation in product form

b) Service opportunities available in specialty retail channels

c) Scope for provision of better solutions to capitalise on growth in institutional foodservice

d) Scope for improving the information and intelligence on market conditions, consumer needs and the requirements of foodservice establishments

Convenience

There is significant opportunity for suppliers to tap into the increasing growth and diversity of non-supermarket retail channels, especially those meeting convenience meals and eating occasions that meet the increasingly complex consumer need.

For suppliers, this will require a fuller understanding the dimensions of convenience – over time these are evolving but we see three distinct elements:

- *Ease of shopping* – in terms of accessibility (physical access and trading flexibility)
- *Meal readiness* – through reduced meal preparation time, welcoming meals components rather than "scratch-preparation" ingredients, but also influencing the shift towards speedier, casual

dining

- *Product form & range* - balancing portion size, along with the necessary fix of nutrition, indulgence, and/or taste

It is well recognised that the large domestic retailers have been a slow – by global standards - to tap into these trends. But while there are abundant examples that flow from the UK, mainland Europe and the USA of model convenience solutions, this is a small and difficult retail market for a major chain retailer to get the investment right.

This does not mean that the only opportunities for generation of new product markets and category growth are outside the large grocery channel, as that format will continue to respond and aim to tap into these convenience requirements.

Casual dining

There is significant expansion in casual dining and takeaway channels, providing scope for suppliers to capitalise of sustained growth through improving the effectiveness of the casual dining offer by providing food solutions oriented towards end-use requirements, and increase the convenience for the foodservice customer and end-user through tailored packaging and delivery. Specialist fresh food retailers and wholesalers have greatest scope in this regard, including servicing local customers and integrating their business model to capture greater value.

Institutional market

The institutional food market is also growing in importance as a higher proportion of our population is ageing. Increased concerns about the nutritional content of diets of people living in care will increase the sophistication of the meal offering.

As the institutional sector expands and the performance demands rise, cost management will become more critical and will increase the likely role of contract meal preparation to specification.

Growth in interest in specialty niche foods

There is increasing consumer interest and knowledge in quality specialty foods which enhance the overall eating experience. This interest may be based on ethical (eg. Organic foods) grounds or a wish to indulge in "the story" of the food. There is scope for wider penetration into supermarket channels, especially if the trend towards local and regional "ranging" is given greater momentum, but also through non-supermarket formats and food service outlets

Avoiding some of the key pressure points

It is foolish to generalise the food industry as a land of opportunity. There are pitfalls and pressure points to avoid and manage, and ongoing risks for suppliers to balance their exposure to multiple channels:

- Fragmented supply sectors - Some sectors suffer from a general lack of market knowledge and limited collaboration in managing supply chain information
- Growth challenge for manufacturers - The deflationary impact of increased sales at typically lower unit wholesale prices through the supermarket channel is constraining growth opportunities for grocery manufacturers, affecting the balance between efficiency of "commodity" throughput and innovation in product extension
- Incentive to innovate - The stronger pressure on the performance of products and brands creates higher investment hurdles and shorter time lines for the proof of product and market innovation.
- Challenging brand proposition - The consolidation of supplier brands and proposed growth of private label creates more stringent requirements on investments in product brands.
- Pressure on category competitiveness - Primary producers and manufacturers are less competitive in certain categories against imported fresh and processed food product alternatives which have scale, labour cost and currency advantages.

Taking up the information challenge

However those opportunities in a) to c) will only be realised with a far greater investment in information and intelligence to allow a better understanding in how to scope, develop and deliver solutions that an evolving market offers.

Product and process innovation will play a large part in the success that can be achieved – adding convenience to a product solution rather than the traditional approach of supplying commodity lines in the form also available in retail stores.

Greater diversity in the consumer market brings a greater need to understand and track the changing consumer. Once it was probably acceptable for the marketing manager to periodically invest in large "use and attitude" studies, but this needs to be balanced with closer tracking to understand the diversity of influences on consumption – especially where this is influenced by season, sensitivity to income shifts, and major events.

There is also greater importance in understanding the cause and effect of changes in supply chain conditions. A great tide of change in the global food market is steadily rippling through the Australian food sector, overlaid by challenges of climate change and the dynamics of our retail market.

Note: FOODmap can be obtained from the DAFF Food website at:

http://www.daff.gov.au/agriculture-food/food/publications/foodmap-a-comparative-analysis