ADVERTISEMENT

Stores, food makers compete on retail prices

Sunday, March 15, 2009
By EMILY FREDRIX and SARAH SKIDMORE
AP Retail Writers

Retailers, who begrudgingly went along when food makers pushed up prices to recoup record-high costs, are flexing newfound muscle and demanding price cuts to match the recent steep retreat in ingredient costs.

Food makers are resisting, saying the uncertain economy and volatile costs make price cuts unwise. But retailers aren't backing down.

Consumers who responded to the higher prices by favoring grocers' in-house products over national brands and by shopping more at discounters may end up with fewer choices all around.

"We don't have to carry three brands," Costco Wholesale Corp.'s Chief Financial Officer Richard Galanti told investors earlier this month. "We can choose between brands that are going to be more aggressive, that help us help our members."

Costco has been lowering its prices, Galanti said, and is prepared to sacrifice profit margins and cut national brands that won't negotiate on pricing if that's what it takes to drive sales.

"We are not the only ones out there pressuring manufacturers," he said.

Steven Burd, president of grocery chain Safeway Inc., recently told investors that it has gotten some vendors to roll back their prices. Like many retailers, it is finding its new strength in its in-house brands, including Safeway Select, O organics and Primo Taglio deli products.

"We're going to chew them up on corporate brands," Burd said of food makers that don't lower prices. "And we're just going to keep driving corporate brands."

The situation grew so tense last month that grocer Delhaize SA in Belgium said it would no longer stock at least 250 Unilever products because the food maker was making "unprecedented" demands that would force retail prices up 30 percent.

The grocer, which operates Food Lion and Sweetbay stores in the U.S., said Unilever also was demanding it carry some products consumers did not want. The two companies apparently reached an agreement this month, though the terms are unclear.

Food makers, which raised prices last year after fuel and some ingredient costs hit record highs in the summer, are leery of dropping their prices in case commodity costs come back up and pinch their profit margins. They say they're still catching up with last year's costs, even as they confront tougher competition from the retailers they rely on to sell their products.

Producers are making some changes that can provide relief to both consumers and retailers, said Frank Luby, a partner with Simon-Kucher and Partners who consults with companies on pricing.

Some are changing package sizes, often shrinking them while keeping prices steady so shoppers don't pay more to remain with their favorite brands.

But this tactic can make them targets of their competitors as ice cream maker Haagen-Dazs learned when it announced recently that it will shrink some of its containers. Rival Ben & Jerry's, owned by Unilever, said on its Web site without naming Haagen-Dazs outright that consumers are hurting just like food makers and they deserve a full pint of ice cream, not just 14 ounces.

Another change food companies are making is to focus promotions which they negotiate with grocers on staples like dairy, cereal and soup, BMO Capital Markets analyst Kenneth Zaslow has said.

Eggland's Best Inc., the nation's largest branded egg company, is asking supermarkets, "If we give you so many cents off, would you give that to the customer," said Chief Executive Charlie Lanktree.

At the same time, many retailers are increasing their promotions of house brands, Zaslow said.

Some 64 percent of shoppers in 2008 said they often or always buy a store brand rather than a national one, according to the Food Marketing Institute, an industry trade group. That's up from 59 percent the prior year.

Kroger Co., owner of Ralphs, Fred Meyer, Food 4 Less and other chains in 31 states, saw sales of its in-house brands hit a record 27 percent of total sales in the most recent quarter.

The company's CEO, David Dillon, said after its most recent earnings report that Kroger is pushing producers back on prices. But he also said high pricing of national brands is helping bring customers to store brands "so we are quite happy in either scenario."

Food companies say they are cooperating with retailers to the extent they can.

Both Kraft, maker of its eponymous macaroni and cheese and Jell-O, and General Mills expect their ingredient costs to remain volatile and neither is offering broad price cuts.

Kraft expects costs to rise about 10 percent this year from $2.1 billion last year as key items like corn and fuel are higher than in previous years. The food maker did drop some coffee and cheese prices last year to align itself with falling input costs, spokeswoman Lisa Gibbons said in an e-mail.

General Mills Inc., the maker of Yoplait Yogurt, Wheaties cereal and Pillsbury products, expects the cost of its ingredients to rise 9 percent in 2009 after a 7 percent hike in 2008, when it raised its retail prices 2 percent to 3 percent.

Luby, the pricing consultant, said cost volatility is a big concern amid other variables, like weak consumer confidence and the stronger dollar, which has dragged down overseas sales by U.S. companies.

"Every penny that I would want to roll back, I'd like to know what I'm going to get for it," he said. "That's a complicated question."

AP Business Writers Aoife White in Brussels, Belgium, and Dan Sewell in Cincinnati contributed to this report. Skidmore reported from Portland, Ore., and Fredrix from Milwaukee.

(Copyright 2009 The Associated Press. All Rights Reserved.)

MORE >>