

Economics Group

Special Commentary

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Grocery Stores' Competitive Pressures Intensify

Executive Summary

In our first report on the United States' retail sector, we analyzed potential pricing pressures coming down the pipeline for the retail trade and food services retail channels.¹ In this report, we take a deeper look at some of these distribution channels and assess aggregate level response to some of these channels to inter-channel competition. To do this we ran several econometric regression equations to try to find out what type of intra-channel competitive pressures exist between these sectors. For this report we concentrated on the grocery stores (GS) and the other general merchandise stores distribution (OGMS) channels, which includes warehouse stores, supercenters and superstores.

Our analysis indicates that competitive pressures between these two sectors of retail have intensified since the recovery from the Great Recession. Although the GC sector's price sensibility to sales has remained strong over the past several decades, now the sector has to deal with a relatively strong cross-price sensibility with the OGMS distribution channel. However, this new competitive environment for the GS sector has actually improved the sector's growth prospects since the end of the Great Recession. That is, after a period of flat sales during the 1990s and the first decade of this century, the sector has started to grow at a relatively strong pace.

Our analysis indicates that competitive pressures have intensified.

Grocery Stores versus Other General Merchandise Stores

Following up on a report we wrote last year, "Are Grocery Store Sales Making a Comeback?," which is available upon request, in this report we will try to measure the competitive pressures that have existed between the GS and OGMS retail sales channels over the last several years and look at the differences, if any exists, in this relationship when comparing the period before and after the Great Recession. That is, we will analyze the entire period for which data are available and then we will compare the period before the Great Recession, without including the Great Recession and the period after the Great Recession. In last year's report we indicated that the grocery store sector of retail had started to look a little bit better vis-a-vis the large supercenters and warehouse stores as growth in that sector had started to improve slightly after the Great Recession and that the tremendous expansion in the warehouses and supercenters was somewhat faltering or slowing down.

¹ "[Will Retail See Some Pricing Power?](#)" available on our website and/or upon request.



Figure 1

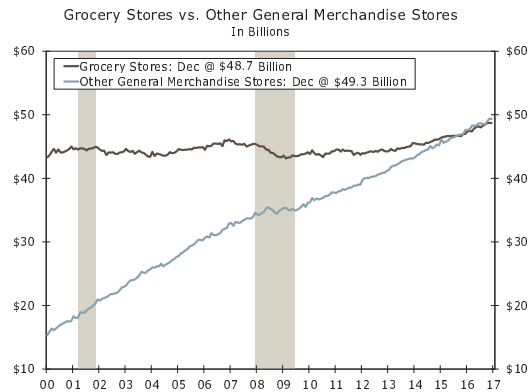
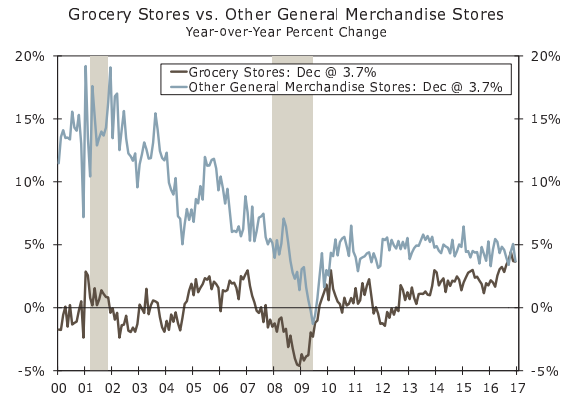


Figure 2



Source: U.S. Department of Commerce and Wells Fargo Securities

Some of these changes may be related to demographic and geographic changes.

Although some of these changes could be due to demographic and geographic changes (i.e., suburbs versus cities, millennials versus non-millennials, etc.), we will look at competitive pressures through price differences between these channels. That is, we will look at how these channels have performed throughout the years under what has been a highly competitive environment, especially between the warehouses and supercenters and the grocery stores sectors.

To do this, we ran several regression equations to measure if price competitiveness between these sectors has been important. The period of analysis goes from the start of 1999 until today, but, as previously stated, we have segmented the period in three: first, we ran a regression for the entire period; second, we ran a regression for the period before and up to, but not including, the Great Recession; and third, we ran a regression for the period after the Great Recession. The reason for this segmentation is that we wanted to see if there has been any change in the characteristics of these markets in the period of pre- and post-Great Recession.

Econometric Results²

The econometric results for the GS sector show a very price-sensitive consumer from 1999 to today. However, according to the result, the competitive pressures were not that strong over the sector, as the cross-price sensitivities, that is, what happened when the OGMS sector changed prices, were not as strong as we would have thought. However, when we segmented the period between pre- and post-Great Recession, the results changed significantly.

During the pre-Great Recession period, the own price sensitivity of the sector was very strong. That is, this period was very much similar to the whole period (1999-2016) when the sector's own price was an important determinant of the quantity demanded of goods for that sector. Furthermore, as was the case during the entire period, price pressures from the OGMS sector was not important in statistical terms. If we look at Figure 1, we will see that GS sales remained more or less flat during this period, while sales for the OGMS sector were growing at a very fast pace.

² Econometric results are available upon request.

Figure 3

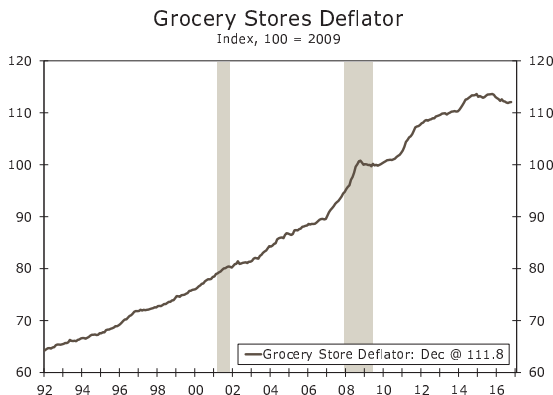
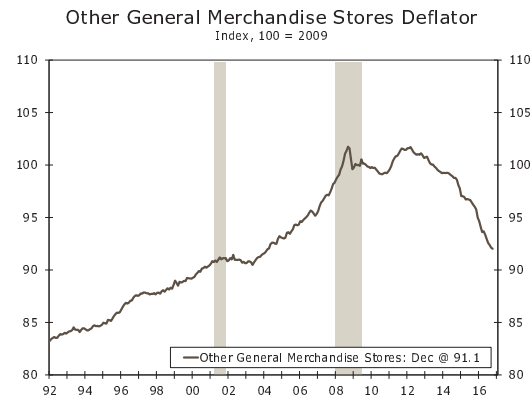


Figure 4



Source: U.S. Department of Commerce and Wells Fargo Securities

However, this relationship is somewhat changed when considering the period after the Great Recession. Econometric results for this period still show a sector that remains very “price sensitive” with respect to the price it charges to customers, but at the same time, it becomes sensitive to competitive pressures coming from the OGMS distribution channel. That is, the cross-price sensitivity, which was not important during the pre-Great Recession period, has become important as well as statistically significant during the post-Great Recession period. Recall that this is the same period that we identified, in our report last year, that grocery store sales were making a comeback.

This means that GS consumers not only remained highly sensitive to the prices being charged by this distribution channel, but they also became highly sensitive to what was happening in a competitive distribution channel, the OGMS sector. That is, while growth in the OGMS sector was not affecting the performance of the GS sector during the pre-Great Recession period, this relationship changed significantly after the Great Recession and now both sectors should be aware that whatever changes they make to their own price strategy will have important consequences in how the other retail distribution channel performs. That is, for the first time since the irruption of the OGMS distribution channel, i.e., superstores, warehouses and supercenters, this channel seems to be battling inch by inch with the GS sector for a larger piece of the grocery and food sales market.

That is, consumers today are sensitive to changes in prices in the GS channel of retail sales and are also highly aware of the role played by the warehouse and supercenter sector in keeping grocery store prices at bay. However, given this new sensitivity by consumers of this channel of retail it is important to note that growth in the GS distribution channel over the past several years has occurred despite this new environment of competitive pressures for the GS sector of retail.

At the same time, and this is something that did not surprise us, the converse is not true for these distribution channels. That is, we also regressed sales of OGMS on the prices of those merchandise stores and the prices charged by GS and the results came out that there is no relationship between own price sensibility and/or cross price sensibilities between and within these sectors.

One of the possible reasons for the lack of relationship between prices in the OGMS distribution channel and GS prices is that the OGMS distribution channel competes with the GS distribution channel but the OGMS distribution channel is much larger than the GS distribution channel. That is, the OGMS distribution channel sells more than just food and groceries, which clouds our ability to extract information from the relevant data. If we had data on only food and grocery sales made by the OGMS distribution channel, our guess is the relationship we observed between GS sales and OGMS sales would be the same whether we look at it from the GS distribution channel side or if we look at it from the OGMS distribution channel side.

After the Great Recession the GS sector became highly sensitive to what was happening in the OGMS sector.

Furthermore, it was also somewhat odd that we did not find any relationship between the price and quantity for the other general merchandise sales distribution channel. However, the fact that this sector has been growing so strongly during this period, i.e., in terms of the number of outlets as well as sales, is probably the reason why price is not an important determinant of sales within this distribution channel.

Conclusion

We have analyzed two sectors that have experienced increased competitive pressures over the past several decades, the GS distribution channel and the OGMS channel, which includes supercenters, warehouses, and superstores. Sales for the GS sector remained relatively flat up until after the Great Recession and have since started to increase. Meanwhile, sales in the OGMS sector have grown considerably since its irruption in the market several decades ago.

Own-price sensibilities in the GS market have remained strong over the past several decades, and now the sector faces even more competition from the OGMS sector as cross-price sensibility with this sector has intensified since the end of the Great Recession. However, even as cross-price sensibilities with this sector have increased, the GS channel has been able to grow relatively strongly in this new environment, which means that the GS distribution channel has risen to the challenge posed by the OGMS distribution channel.

***Cross-price
sensibility with
the OGMS sector
has increased.***

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