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On Behalf of the National Grocers Association

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Power Buyers and the Impact on American Consumers

My name is David Smith. I am the President and CEO of Associated Wholesale Grocers, or AWG, which is based in Kansas City, Kansas. AWG supplies over 3,100 supermarkets in 28 states. I'm testifying today on behalf of the National Grocers Association, the national trade association for independent community grocers and their wholesalers.

The grocery industry is my life. I've grown up in independent grocery stores and have dedicated my life to making independent grocery stores viable for the future. Today, I'd like to tell you about the grocery industry and the problems that we see flowing from high level of concentration in the supply chain.

The Grocery Industry & The Benefits of Independents

First, I would like to provide you with a bit of background on the grocery industry. The grocery industry is an approximate trillion-dollar retail segment of the U.S. economy. There are about 38,000 supermarkets, employing approximately 5 million Americans. Notably, our industry invested $24 billion due to COVID-19 to help keep our employees and customers safe.

My company, Associated Wholesale Grocers, or AWG, is a cooperative wholesaler supplying groceries, produce, perishables, and general merchandise, as well as an array of support services to over 3,100 stores in the United States. We have approximately 1,100 owner/shareholders, predominantly family businesses, all of whom live and work in the communities in which their stores are located. In addition to AWG, there are seven other cooperative wholesalers in the United States, and several other companies that provide products to independent grocery stores in the United States. Independent grocers like those who are the owners of AWG account for almost 1.2% of the nation's overall economy and are responsible for generating $253B in sales, 1.1 million jobs, $42B in wages, and $36B in taxes. Overall, grocery represents $1 trillion of the nation's economy.

The size of the grocery stores supplied by AWG and similarly situated wholesalers varies widely. A store in a small rural area of Kansas may purchase less than $10,000 per week, while a grocery store in a Chicago suburb may purchase over $500,000 per week. As a result of having diverse ownership of stores, diverse communities served by the stores, and diverse store sizes, there is very little one-size-fits-all for our stores.

All of this is a way of saying, the independent grocery retailer is exceptionally diverse by design as they cater to the communities they serve and have positively differentiated their businesses through their offerings, service, quality, and freshness of products, and by being a local business with a heart for the communities they serve.

In 2020, AWG had wholesale sales to member retailer stores of $10.6B, and the aggregated retail sales of these stores totaled over $22B. The gap between retail sales and wholesale purchases is generally not due to markup; stores purchase substantial inventory from other sources, locally and through direct store delivery. Operating expenses in our industry represent 85% or more of the gross margin, from salaries to fixed facility costs and utilities, to credit card fees (a story for another day), to supplies and donations to the local food pantry, and sponsorship of the local soccer and baseball teams. The average supermarket net profit after taxes for 2019, according to FMI, The Food Industry Association, is 1% of sales, ranking our industry among the lowest in recorded net profitability.

Independent grocers and their wholesalers play a crucial role in American communities. They compete to offer low prices, higher food quality, better service, more accessible and convenient locations, a greater variety of products, and good jobs.

The Problem: Buyer Power in the Grocery Aisle

AWG has had a front row seat to increasing levels of concentration in the food supply chain in recent decades—both at the retail level and among suppliers like meatpackers. Today, 1 in 4 grocery dollars in the United States are spent at Walmart. Our 3,100 stores, which comprise $22 billion in sales for the industry, can look like peanuts compared to the dominant retailers. Walmart derives almost $300B of their $514B in retail sales from grocery. Kroger brings in $121 billion. We estimate Amazon, which doesn't break out its grocery sales, is at approximately $70 billion. Finally, Alberton's brings in $61 billion and AholdDelhaize brings in $44 billion. That's almost $600 billion—or 60% of the entire industry's sales—in the top 5 retailers.

High levels of concentration allow the dominant retailers to act as gatekeepers to consumers. These retailers use their control over the market to advantage themselves at the expense of everyone else. They dictate terms and conditions to suppliers, including more favorable pricing and price terms, more favorable packaging, and access to exclusive products. Some even pressure suppliers not to sell certain products to independents. And because of their position as gatekeepers to so many shoppers, suppliers have no choice but to acquiesce. These dominant retailers, which we call power buyers, in some cases represent 35% or more of a supplier's total sales. In a razor-thin margin business, those suppliers have no choice but to comply with big retailers' demands—or face crashing stock prices or worse yet, closure.

For some products, power buyers extract such an unfair advantage that their retail prices are lower than the wholesale prices available to independent grocers—making it impossible for independent grocers to compete on price. At times, the wholesale prices available to local store owners are so high that they resort to buying product directly from a competitor like Walmart or Amazon, because these dominant retailers are offering a lower price than the wholesale price from the store's supplier. Needless to say, this makes it impossible for local store owners to compete with dominant retailers on price.

In response to the problem of the buyer power at the retail level, suppliers have consolidated to gain their own economic power. Consolidation at retail causes consolidation upstream in the food supply chain, and meatpacking is one stark example. In meatpacking, a small handful of powerful, vertically integrated companies control the entire market. And we see this type of consolidation everywhere – from protein, to consumer packaged goods, to even private label manufacturing. These problems are interrelated, and it begins in the grocery aisle.

In meatpacking in particular, farmers and ranchers face the same buyer power problem we do. With such a high level of concentration in meatpacking, the dominant players dictate prices to farmers and ranchers, who have no one else to sell to and therefore no choice but to acquiesce, even with prices so low that they are pushing these workers into poverty. And consolidated supply chains are more vulnerable to disruption, as we saw with meat during the pandemic.

Ultimately, we have seen the result of concentration in the communities we serve. Long after the seemingly good deals and better prices are gone, there is less competition, higher prices, and less availability and access to fresh, healthy, and affordable foods. Local, independent store owners lose out. They can't get access to products that consumers want. Rural families, urban families and communities of color, who often live in food deserts where the big box stores aren't nearby, don't have easy access to healthy foods when they don't have access to independent stores. So they lose out disproportionately.

Who else loses out? People who prefer shopping at a local store or who don't have easy access to transportation. And store employees, whose jobs are disappearing as local and independent stores close down. Ranchers, farmers, manufacturers, and suppliers — they struggle to get fair prices as fewer firms compete for their product. And entrepreneurs who dream of opening an independent store lose out, as running an independent grocery store becomes increasingly impractical.

The Food Supply Chain & COVID-19

I want to take a moment to provide a bit of background on the two primary ways that grocery stores set retail prices, and why this mattered during the pandemic.

The vast majority of grocery retailers, including the majority supplied by AWG, follow an everyday and sale pricing strategy. In ordinary grocery shopper terms: they have a regular shelf price that is based on a retail pricing zone with suggested retail prices for a geographic region, and then every week, with the help of special allowances provided by suppliers, run sales on specific high-demand items, sometimes well below the retailer's wholesale acquisition cost net of all allowances and promotional dollars. So, if you go into a store today for mayonnaise, it may be $4.99, but if it is on special, it may be 2 for $5.00 or even $1.99. These sales or special prices are available to these retailers due to promotional dollars provided by the vendors and augmented by significant reductions to the standard product markup by the retailer.

A number of the power buyers, including Walmart, go a different route and negotiate with vendors for flat, reduced prices – known in the industry as "Every Day Low Price" or EDLP. As a result, those retailers require suppliers to bill them at a net cost on every shipment and do not receive the additional advertising dollars based on promoted pricing.

Now, you may be wondering why this is important in this antitrust discussion. It became crucial in the past year when suddenly manufacturers could not produce the quantities of products necessary to supply all retailers with the desired inventory levels. As a result, the manufacturers placed allocations and restrictions on product flow to retailers and suppliers. While we never like being on allocation, we agreed with the concept of making sure each purchaser could get access to their fair share of products since supplies were suddenly scarce. There was not enough to meet the demands of consumers, and we were willing to do our part. Unfortunately, though we gladly provided the retail demand information by item and location back to the suppliers, we could not receive the same visibility to the supply side production of product or availability at the manufacturing facilities. This lack of transparency by the suppliers frustrated our expectations of fair allocations, a subject I will discuss later.

Allow me to make it clear, the pandemic was not the first time power buyers undertook anticompetitive activities; it was just the mechanism by which these activities, which we know have been going on for decades, but could not easily prove, were laid bare for all to see. As the pandemic began and panic buying ensued, our shelves were decimated. The last thing a manufacturer wanted was a reduced or sale price on their product to encourage accelerated sales on products they couldn't produce. In a situation like ours, we suddenly found that the advertising dollars that our retailers had already earned by buying a full assortment of the manufacturer's products and counted on receiving when setting their shelf prices were non-existent. Yet, manufacturers did not reduce prices or offer these advertising dollars to purchasers to offset the higher retail prices. At the same time, those who had negotiated EDLC pricing could take advantage of reduced prices without the need to run any of the planned and anticipated sale campaigns.

This stark contrast in pricing strategy resulted in substantially higher costs at wholesale for independent grocery stores, subsequently higher prices at retail, and the double impact of scarce products and higher prices for consumers. Our stores did not raise retail prices or increase their profit margin expectations during COVID. The higher retail costs consumers experienced were due to the substantial reduction in promotional spending by manufacturers as they couldn't meet retail product demands and pulled promotions to control output.

As I mentioned earlier, product allocation was a prominent issue over the past 16 months. Without providing us with visibility of how much they were producing, they told the industry as a whole that we were all receiving our fair share of products. But in fact, independent grocery stores did not receive their fair share. I spent months last year receiving photos from AWG member retailers of their empty shelf sections at their stores, as well as pictures from those same member retailers of whole pallets of the products missing from independents' shelves in the big box retailers across the street. Sanitizers, disinfecting wipes, paper towels, toilet paper, the list goes on and on. When we asked some of these suppliers, they told us, "we provide priority to mass merchants, as they support healthcare workers and the front line." Hence, they received first preference alright—an extremely frustrating answer for our retailers who serve front-line workers and their families every day. The distinction was not really about the consumers they served because the supply to healthcare went through supply companies and not retailers. Hospitals don't send someone to buy their antiseptic wipes at Walmart or Sam's Club. The real reason dominant retailers were prioritized was because they demanded it—and suppliers had no choice but to yield to the incredible leverage they wield.

To add insult to the injury we were already feeling, in the Fall, when inbound supply was still running behind at only 85% of pre-pandemic levels from manufacturers, Walmart issued a new on-time and in-full mandate. In the middle of a pandemic with supply chains interrupted, Walmart demanded that suppliers must deliver 98% of orders on-time and in-full or pay a 3% penalty of the dollar amounts outside those requirements. This demand came at a time where almost no manufacturer had recovered from the initial panic buying at the beginning of the pandemic, at a time when COVID positivity rates were still climbing, at a time when there was no vaccine, and at a time when the industry was attempting to prepare for the most unpredictable holiday period the industry has ever encountered.

The impact of this requirement is clear—suppliers are forced to prioritize Walmart's orders over the orders of Walmart's competitors. Across the industry, suppliers are only running at 85% capacity. And no supplier can afford to pay a 3% penalty in an industry with a net profit of 1%. To comply with Walmart's demands, suppliers would need to reduce the service level to all others to 81% or less, further exacerbating the existing supply issues for independent stores—all to the benefit of Walmart.

We were also floored by the candor of the nation's only full-line canning supplies company when they sent us, as well as many other similarly situated companies, a letter stating that since they couldn't meet demand, they had decided to play favorites and only supply the top 6 retailers, even going to the point of listing those retailers on their website. Remember, it is independent retailers located in small, rural communities that supports the consumer that does the most canning and freezing of homegrown produce and proteins every year. This strategy would have forced many rural consumers to drive 40 miles or more to get the supplies they needed. Ultimately, the company reconsidered their plans. But this episode reveals the pressure suppliers face from power buyers, and the confidence that both power buyers and suppliers have that openly advantaging some competitors at the expense of others will not lead to antitrust enforcement. The company was so confident that it could pick winners and losers that it actually sent out letters to each of its customers informing them that they had decided to play favorites and that we – the independent grocer – were not among the chosen few.

Finally, beef pricing during the pandemic rose dramatically, even though farmers and ranchers were paid less and retailers and wholesalers were paying more. The only explanation for this is consolidation—meatpackers used the pandemic and supply shortages as an opportunity to squeeze their upstream suppliers and their downstream customers, boosting their own profits at everyone else's expense. To make matters worse, some independent grocers were wrongly accused of price gouging in 2020. But in the cases of alleged price fixing, investigators found that stores were simply passing through a portion of their own increased costs to consumers. In fact, retail profitability on fresh meat actually fell during this time as many independents absorbed costs increases from meatpackers and processors to protect their retail customers from monopoly pricing.

Consolidation & Supply Chain Fragility

In addition to the harms that flow from buyer power, concentration also makes our food supply chain fragile. In the last 16 months, COVID-19 revealed the dangers of a consolidated meat supply chain. Today, meatpacking plants are so concentrated that coronavirus outbreaks at a small number of plants led to disruptions and shortages across the entire beef, pork, and poultry supply chain.

NGA's members, in contrast, showed the benefits of diverse ownership during this time. Many NGA members employ butchers that cut fresh meat from primal cuts. The dominant retailers, in contrast, primarily sell prepackaged meat produced through central processing facilities. Many consumers prefer store meat cut fresh by experienced butchers, without additives or solutions, which may be as much as 10% of the meat's weight by volume.

When the pandemic impacted processing centers, many of NGA's members fared better because they continued to have access to bulk meat that they then prepared in store. Other NGA members facing supply shortages were able to secure excess supply from restaurants and caterers to keep meat on their shelves. Dominant retailers like Walmart were nowhere near nimble enough to respond to disruptions in this way, and no meat was available in their stores until the dominant suppliers could supply it.

The Impact of Unrestrained Buyer Power on the Food Supply Chain

Companies like AWG, which has a total of 8 full-line grocery distribution centers, have been working for decades to make sure our retailers can take advantage of the economies of scale. In fact, that is what initially brought the original owners of AWG together back in 1926 to protect themselves against a much larger retailer entering the marketplace. We combine our purchases in the most economical fashion, buying by the truckload, and operate highly efficient billion-dollar-plus warehouse facilities, just like the power buyers. Still, we cannot obtain the same terms, conditions, and pricing as the power buyers.

One primary reason for this is that the playing field is not level. The dominant grocery retailers are not nearly as dependent on a particular supplier as the supplier is on the retailer. Think about it, even if a manufacturer has a substantial number of products compared to the overall number of products for sale in any grocery store (in the tens of thousands), the total amount provided by a single manufacturer is only a fraction of a grocery retailer's sales. And a power buyer often enjoys a choice between several potential branded suppliers for a particular product in addition to selling its own, private-label versions of the same product. As a result, a dominant retailer has a substantial advantage over its suppliers in a negotiation because the risk for the retailer, if the supplier refuses its demands and no deal results, is substantially smaller than it is for the supplier. As a result, the power buyer can extract discriminatory terms – better prices, more favorable terms, unfair allocations of products.

The U.S. House Judiciary Committee found that Amazon exercises significant market power over suppliers. The Committee found that Amazon and Walmart ignore minimum advertised prices set by brand manufacturers, by which other sellers must abide, as there is effectively no different path to reach their customer base. Unfortunately, with power buyers now dominating the grocery industry, we have no point of reference for the real economies of scale and performance levels. Those are hidden and kept in secrecy, shielded by explanations such as separate classes of trade, partnership agreements, and other special arrangements.

We continue to grow and prosper as a company, but the pool of independent grocers is declining. That's detrimental to our communities, our economy, and the family unit. The local grocer is the backbone of the communities they serve. These stores are particularly important to inner-city and rural communities, many of which would otherwise suffer from a lack of access to healthy foods. When independent grocers leave, food deserts emerge. Small towns begin to fall apart, and our government spends billions each year trying to rebuild. But it's too late after all of the grocers leave. Prevention is the only way to stop this costly erosion.

Our most vulnerable population, generally the most financially challenged, is affected most, causing food insecurity, poor diet, increased health-related risk, and increased demands for governmental assistance. They need access to fresh, healthy, affordable food, and we want to provide that for them.

We want to clarify that we do not see the vendor/manufacturer as the bad guy in this issue; in fact, they are the primary victim. Many food manufacturers state in their SEC filings that the increasing control that dominant players have over their business is one of the greatest business risks they face.

As far as meeting the needs of retailers, wholesalers, and consumers, I believe manufacturers and suppliers do a great job given the demands. Still, they are in an untenable spot where they must disappoint and disadvantage the less powerful to serve the bidding of the power buyers. Their survival requires it.

As we all know, incremental volume on a fixed cost basis produces economies of scale and reduces the cost to serve as sales increases. But this also applies only to a specific point when capacity is reached. Then when existing capacity is exceeded, capacity must be added, increasing fixed costs, which cannot easily be reversed. The economies of scale are then superseded by the law of diminishing return as the incremental cost to increase capacity must then be applied across the entire block of business. Accordingly, the potential loss of significant retailers brings a far greater vulnerability to the supplier as they can seldom unwind the capacity expansion necessary to supply the growing power buyer. This is precisely what has happened, and as there is no protection for the manufacturer and supplier, and bucking the system to stand up to these largest retailers is clearly financial suicide, they must improve profitability on the balance of their business to remain viable as the power buyers segment of their business is too big to lose and the pricing required is too low to be sustainable on its own. So the cycle continues.

Antitrust's Failures to Address Buyer Power

I am not a lawyer. I sell groceries to make a living. But as I understand it, the antitrust laws were designed to protect consumers and suppliers from firms with buyer power. It has only been in recent decades that our antitrust laws have gone unenforced in this space, because of a theory that consumers benefit from reduced pricing above all else. But this legal standard—which is meant to protect consumer welfare—is doing just the opposite. Americans who happen to live in communities serviced by an independent must pay higher prices for fewer options, and are left behind in supply crunches. At the same time, dominant firms rake in record profits, get preferential terms, and engage in a pattern of behavior that wipes out competition. And even for Americans served by the dominant retailers, the short-term prices they get cannot be considered a consumer benefit, when the end result is higher prices and less choice.

AWG does retail price analyses every four weeks on the regions where we do business. We look at the power buyers in each region and compare their retail prices to our suppliers' costs. Using Walmart as a prime example, our monthly research shows that their retail pricing varies significantly by market depending on whether they face competition. On June 7, 2021, for example, the highest Walmart pricing in our eight region study versus the lowest varied by 3.08%. In May, the variance was 3.22% and in April it was 3.06%. It's like this every month. The regions that are at the highest and lowest change over time, but there are always substantial variances. Why is that? Two words: **Harvest** and **Invest**. In regions where a power buyer dominates the local market and drives out the competition—and there are many—the power buyer **harvests** its power by charging consumers higher prices. And in areas where there are still battles to be won, they **invest** retail gross margin in the form of reduced retail prices. This is not a theory; it's a fact.

As a grocer of more than 40 years, I've seen it happen over and over again. It's why rural towns like Mitchellville, Iowa, and urban centers like South Chicago can only rely on dollar stores for their grocery needs. Senators, if you've ever been in one of these stores, you know: they're not where a family can go for healthy food or abundant choices.

So, do consumers benefit from the increased competition? Yes. We appreciate and believe in competition and we are up to the challenge. But consumers do not ultimately benefit from the predatory tactics used by power buyers. The ultimate goal of these retailers is to eliminate competition by dominating the markets, creating a monopoly, and harvesting with increased retail pricing.

If we want to protect Americans from the impact that monopolies can cause, we need to look further than just big tech. We choose to use social media and search engines, but we all must buy groceries and eat. Accordingly, we need to look into the unfair and unjust buying advantages afforded to the power buyers. Bring the manufacturer and supplier buying brackets, the scale at which specific discounts and allowances are available, out into the light, so all of us are afforded an equal and fair opportunity to work for and achieve the best cost—the best cost for retailers and the best prices for consumers. Give everyone a shot at competing fairly. This will genuinely preserve competition for the long haul, not just until the contest is gone.

Our company was founded in 1926 to help independent merchants achieve scale and buy competitively. While companies like AWG make the cost of goods clear to all our customers, this transparency no longer exists at wholesale. When I began my grocery career in the 70's, there was a different cost for a case, for a pallet, and a truckload. Everyone knew those costs, and we bought the best we were able to do. It was fair, and it was transparent. We long for that level of transparency and fairness.

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