

# MARKETING COSTS

## Labor Accounts for Nearly Half of Food Industry Operating Costs

Of all the food industry operating expenses, labor accounts for the largest portion — 38.5 percent of the food marketing bill (see Figure 1), according to the U.S. Department of Agriculture (USDA). The bill covers all the costs to process, pack, distribute and sell food products — from the farm to the retail store or restaurant.

The marketing cost was \$717.5 billion or 81 percent of the \$880.7 billion spent on food from U.S. producers in 2006, according to the most current data available from USDA’s Economic Research Service. The remaining 19 percent, or \$163.2 billion, went to farmers.

In the marketing bill, the second highest cost after labor is packaging at 8.0 percent, followed by transportation at 4.0 percent and fuel and electricity at 3.8 percent. Electricity is needed for lighting, freezers, refrigerators,

and computers and other technologies integral to food retailing. Fuel powers the industry’s extensive distribution system — a logistical achievement that moves billions of groceries weekly to well over 100,000 retail food stores, including 35,000 supermarkets, superstores, supercenters and combination stores that each carry 15,000-110,000 different products.

## The Gross Margin and Retail Labor Costs

The difference between a food retailer’s cost for merchandise and the shelf price is the gross margin. This margin (expressed as a percentage of sales) pays the retailer’s marketing bill and provides some profits

In 2007, the gross margin averaged 29.3 percent of sales (see Figure 2).<sup>1</sup> Of all food retailing expenses, store labor accounts for the largest portion with payroll at 11.5 percent of sales and employee benefits at 3.6 percent — together comprising more than half of the gross margin. Food retailers posted a net profit of 1.91 percent in fiscal year 2006-2007.<sup>2</sup>

## Building and Remodeling Trends

To keep pace with changing consumer needs, retailers make major investments to build new stores and remodel existing ones. To build a new store, food retailers invested a median of \$6.5 million in 2006 or \$146.70 per square foot — about the same as the previous year, but

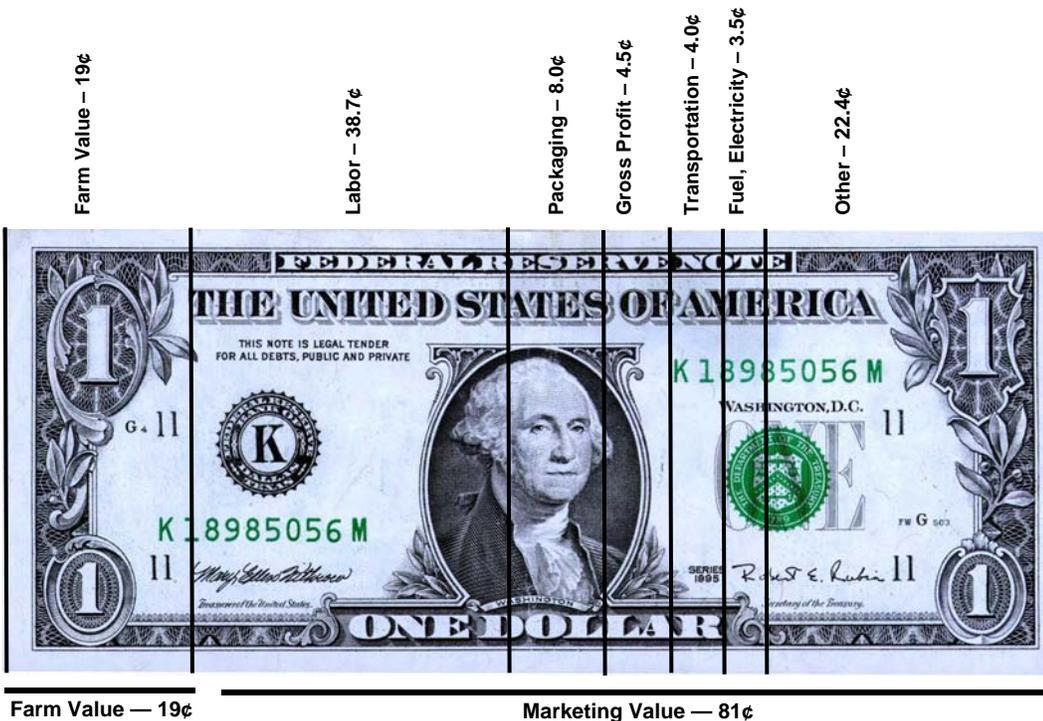
still a significant expense as the cost of building materials remains high.<sup>3</sup> The median décor costs rose from \$4.25 per square foot to \$7.42 in 2006.

Store openings (6.2 percent) exceeded closings (2.0 percent) in 2006. The number of openings was higher than the 4.0 percent figure in 2005, although remodeling activity declined to 3.7 percent, from 4.5 percent, affected by increased construction costs. The median capital investment for a major remodel was \$2.8 million in 2006 — up significantly from \$1.9 million.<sup>4</sup>

Industry experts estimate that a typical store requires remodeling 10 years after it opens and

**Figure 1. What the Consumer’s Food Dollar Pays For**

(Covers food bought at retail stores and restaurants)



\*Includes depreciation, rent, advertising and promotion, interest, taxes, licenses, insurance and professional services, and foodservice in schools, colleges, hospitals, and other institutions.

Source: USDA Economic Research Service, May 2008

**Figure 2. Food Retailing Operating Costs**

<b>Total net company sales</b>	<b>100.0%</b>
<b>Cost of goods sold</b>	<b>70.7</b>
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<b>Gross Margin</b>	<b>29.3%</b>
<b>Total payroll</b>	<b>11.2%</b>
<b>Employee benefits</b>	<b>3.6</b>
<b>Property rental</b>	<b>1.8</b>
<b>Depreciation &amp; amortization</b>	<b>1.4</b>
<b>Utilities</b>	<b>1.4</b>
<b>Supplies</b>	<b>1.0</b>
<b>Maintenance and repairs</b>	<b>0.7</b>
<b>Taxes and licenses</b>	<b>0.4</b>
<b>Insurance</b>	<b>0.3</b>
<b>All other operating expenses</b>	<b>4.3</b>
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<b>Total operating costs</b>	<b>26.3%</b>

Note: Percentages may not add up to 100 percent due to rounding.  
Source: FMI, *The Food Retailing Industry Speaks, 2008*

Years after it opens and every six to seven years thereafter to improve its appearance, efficiency and operation.

More than two-thirds of retailers (68.1 percent) plan to build new stores in 2008, and 77.7 percent are planning remodels.<sup>5</sup>

The median existing store measures 47,500 square feet.<sup>6</sup> The size of new stores increased to 46,000, up from 44,753 square feet in 2005 — still well below the 55,000-square-foot range in the 1990s.<sup>7</sup>

Many food retailers are building smaller stores that target niche markets, such as consumers demanding organic, ethnic, gourmet or Hispanic foods. Some are testing smaller outlets that emphasize fresh and prepared meals in response to consumer demand. This trend marks a competitive response to big-box discount retailers as companies compete by offering more specialized products and higher levels of customer service.

The typical retailer carries a median of 45,000 items. The number varies widely, from 31,750 items in a conventional supermarket to 80,500 in a supercenter.<sup>8</sup>

Competition has pushed companies to upgrade their stores and offer new services. Food retailers continue to offer customers the convenience of one-stop shopping. For example, most retailers today feature fresh, prepared foods for takeout (94.9 percent), floral departments (85.1 percent); and pharmacies (67.1 percent). Targeting market niches, numerous stores include ethnic offerings (84.8 percent) and aisles or sections for organic and natural foods (74.6 percent).<sup>9</sup>

Retailers are also heeding consumer calls for fresh foods (see Figure 3). Most retail food stores today include a deli; fresh, prepared food; fresh seafood; and bakeries. Nearly as many devoted an aisle or section to organic and natural foods, catering to consumers on diets to promote well-being. Even sushi stations are starting to become common. ■

**Figure 3. Stores Deliver Fresh Foods**

<b>Fresh food deli</b>	<b>87%</b>
<b>Bakery</b>	<b>86</b>
<b>Fresh, ready-to-eat/heat foods</b>	<b>85</b>
<b>Natural or organic food</b>	<b>82</b>
<b>Fresh seafood</b>	<b>75</b>
<b>Sushi station</b>	<b>23</b>

Source: FMI, *U.S. Grocery Shopper Trends, 2008*

<sup>1</sup>FMI, *The Food Retailing Industry Speaks, 2008*

<sup>2</sup>FMI, *2006-2007 Annual Financial Review*,

<sup>3</sup>FMI, *Facts About Store Development, 2007*.

<sup>4</sup>*Ibid.*

<sup>5</sup>*Ibid.*

<sup>6</sup>FMI, *The Food Retailing Industry Speaks, 2008*.

<sup>7</sup>FMI, *Facts About Store Development, 2007*.

<sup>8</sup>FMI, *Food Marketing Industry Speaks, 2008*.

<sup>9</sup>*Ibid.*



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