

Can Ghetto Groceries Price Competitively and Make a Profit?

This paper examines the question of whether or not the low-income sector of an urban area can be provided with competitively priced grocery stores that can operate profitably.¹ The study is based on data for Atlanta, Georgia, which has a large urban poor, predominately black. The data are prices charged by regional grocery chains, full-line independents, and a small, four-outlet chain operating in the ghetto, with additional volume and operating-cost data for the small chain.²

For groceries in the ghetto to operate profitably at competitive prices, their sales volume, costs, and markup must not differ greatly from those prevailing in the higher-income areas. This note will summarize briefly the levels of sales volume, costs, and markup in ghetto areas as compared with higher-income areas. Then, it will concentrate upon the favorable effects that the sales mix has on profitability of ghetto groceries selling to the low-income consumer. It will be shown that where the poor are predominately black, their purchasing patterns enable the ghetto chain to earn higher gross margins, other things being equal. Thus, even if risk were considered to be higher in the ghetto, so might profit be higher without prices for the poor shopper being higher than those charged in nonghetto stores. In fact, the small, four-outlet chain studied serviced the grocery needs of the poor at lower prices than all but one chain in the city. Since many cities have large concentrations of poor blacks and a dearth of large chain stores in the ghetto, this is of some import. Moreover, it points up the need for further study to determine if similar purchasing patterns exist for all urban poor.

SALES VOLUME

Competition in the retail grocery industry has resulted in markups that are not large enough to allow very much variation below an optimum range of sales volume before fixed costs erase profit margins. A well-located small chain outlet in the heart of the lowest-income section of the

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1. "Low-income" and "ghetto" will refer to areas with family incomes averaging \$5,500 and below in 1968 prices. The average size of family is six people.

2. The empirical basis for this article is an unpublished report of a study undertaken by the authors for the School of Urban Studies, Georgia State University, entitled "Food Prices in Low Income Areas," Atlanta, Georgia, Urban Life Center, 1969.

ghetto had competitive prices and sales of \$876,000 per year in 1968 prices. This is below the average of \$1,579,000 for chains with sales below \$100 million per annum in the South, but is a viable-size store in terms of profitable sales volume.³ The break-even point on ghetto stores charging prices comparable with chain prices outside the ghetto was between \$600,000 and \$700,000 annual sales in 1968 prices.

Sales volume of the necessary size can be obtained in ghetto areas. As a result of lower density of population and a lower percentage of expenditures spent on food, food expenditures per residential acre by the population where family incomes average \$20,000 in Atlanta are \$4,700, less than half of poverty-area expenditures where incomes average \$3,500. Families in the intermediate ranges of income in Atlanta spent \$5,400 per residential acre on food compared with \$12,000 in the densely populated poverty neighborhoods.

COSTS

The case study of Atlanta found that a small chain, while not experiencing all the cost advantages of the larger chains, operated profitably in the ghetto. Local cooperative warehouses are large enough to supply groceries, with some exceptions such as frozen foods, at prices competitive with those of chains. Produce and meat may not be available to the small independent on a basis comparable with that of chains. The small chain in our study, however, was able to purchase meat and produce just as cheaply as the large chains. Prices and gross margins as a percentage of sales for the small chain were comparable with those of larger chains. The only expense item where the costs to the small chain operating in the ghetto were not comparable with those of chains in the South with annual sales below \$100 million was payroll expenses. These were 11.5 percent of sales for the small chain compared with an average for chains in the South in 1968 of 9.85. Since labor costs is a semifixed expense to grocery stores, the volume of sales will influence the efficiency of labor use and hence its costs. Interestingly, lease expenses and pilferage were not higher in low-income areas.

MARKUP AND SALES MIX

The general pattern of large-chain pricing is a framework within which the full-line independent operates. There are several interconnecting links that lead to this result. Given the mobility of even the poor consumer in the United States, most groceries lack a complete locational monopoly. However, the degree of locational monopoly that does exist, the less competitive attitude of many independent grocery store owners toward pricing, and the higher costs experienced by some independents, result in

3. Comparative data for sales, margins, etc., used in this paper are from *Operating Results of Food Chains 1967-68*, Cornell University; and National Commission on Food Marketing, *Organization and Competition in Food Retailing*, Washington, D.C., 1966.

higher prices being charged by independents than by chains.⁴ Yet the disparity cannot exceed certain limits lest the independents lose most customers. Moreover, when the independents are members of cooperative or voluntary wholesale organizations, they tend to follow suggested markups that are related to established markups of the price leaders in the industry.⁵ Individual chains price uniformly, with local produce exceptions, over a geographic region that is not confined to city or metropolitan limits. Thus, their pricing policies are developed in response to the buying habits of the middle-income consumer who makes up the bulk of the geographic market and an even larger proportion of most chain sales.

The consumer's market basket in the low-income area will include many items that are not big sellers in higher-income areas and, according to pricing techniques used by the chains, such items usually carry a higher markup. That is, low demand for items such as pigs' feet by the *average* consumer leads to a relatively low price. At this low price, the less elastic demand for these items by the *average* consumer warrants a relatively higher markup on pigs' feet than on ham by chains pricing for the total market. Since the chain's pricing is the framework within which the independent operates, the mix of products sold by independents or chains in lower-income areas will tend to produce higher margins. This is especially true since the independent tends to run fewer specials than large chains, and the chains operating in low-income areas will be running specials on some items not in high demand in low-income areas wherever specials are geared to the average-income market.

A characteristic of the small chain under study (and a point well understood by the director) is that meat sales to the poor have especially good margins. Low-markup beef items highly advertised by the large chains are less demanded than higher-markup beef items, and beef is less in demand than the higher-markup pork. Records from 1963 through 1965 show that gross margins for meat as a percentage of sales ranged from 20 to 22 percent for supermarkets.⁶ The same margin for the poverty-area store of the studied chain was 27.5 percent in 1968. Yet the index of meat, fish, and poultry prices charged by the most competitive chain in Atlanta was 106.58 percent of the poverty-area prices of the small chain studied.⁷

The markup on individual cheaper meat items such as oxtails and pigs' feet, ears, bellies, neckbones, and streak of lean was between 22 and 25 percent. The store was under no pressure to meet large chain-store competition on the more expensive beef items so often run as specials,

4. See *Organization and Competition in Food Retailing*, chap. 16.

5. W. Alderson and S. J. Shapiro, "Toward a Theory of Retail Competition," in *Theory in Marketing*, ed. R. Cox, W. Alderson, and S. J. Shapiro (Homewood, Ill.: Richard D. Irwin, Inc., 1964).

6. *Organization and Competition in Food Marketing*, p. 226.

7. L. Donaldson and R. S. Strangways, "Ghetto Food Purchases and Prices," *Mississippi Valley Journal of Business and Economics* 7 (Fall 1971): 67-73.

although it tried to be competitive on chicken. Beef made up only 15 percent of meat, fish, and poultry sales. Pork, which carried a markup on the average of 5-7 percent above beef markups, made up 55 percent of meat, fish, and poultry sales. Meat, fish, and poultry sales accounted for 35 percent of total sales in the low-income area whereas it often makes up as little as 24 percent of sales in higher-income areas. Groceries, which made up 56.5 percent of total sales, and produce, which made up 8.5 percent, had margins only about 1-2 percent above the chain-store averages. Interestingly, the profitability of meat sales is not enough to overcome the importance of a volume of sales high enough to reduce fixed costs. The smallest store of the small chain under study specializes in meat sales, but it is operating at a loss because of a volume of only \$333,000 per year. A large chain operating in the poverty area has prices 10 percent higher than this small chain and is still operating at a loss because of low sales.

COMPETITION AND THE SALES MIX

Is it likely that competition in the ghetto will erode the sales-mix effect upon profits? In Atlanta approximately 90 percent of the chain-store grocery outlets were located outside the low-income area, and only one small chain competed with the independent grocer in this area. Reasons given included managerial and employee aversion to the area and the lack of shopping-center locations. (The assemblage of land in the more congested areas of the city is difficult and expensive, especially for a shopping center, and the chains have a preference for shopping-center locations.) Were these roadblocks removed, the next question would be: Would chains drop their practice of uniform pricing geared to purchases of the average consumer within geographic areas? That is, would they break up large pricing areas so that in the ghetto area staples in the consumer's market basket would not carry markups reflecting their specialty status in the wider market? Arguments against increased diversity in pricing are the costs involved in markup differentiation within accounting areas and the difficulty and expense of moving away from uniform advertising throughout an area.

In addition to potential competition in the ghetto from large chains, there is the possibility of additional ghetto chains developing out of ghetto independents anxious to eliminate their cost disadvantages through enlarging their number of outlets. Based on our case study of the costs of the one small chain operating in the Atlanta ghetto, it is unlikely that such chains could achieve costs as low as the costs of large chains; nor are small chains likely to have as competitive a behavior pattern. Moreover, if one small chain were the price leader in the ghetto market, as in our study, it would have little incentive to erode the sales-mix effect by driving down meat markups on items typically consumed by the poor. An astute price leader among the small chains would sense a relatively inelastic demand curve for meat items consumed in large quantity by the

poor. Prices on such items are low relative to other meat items, and non-meat items are imperfect substitutes for low-priced meat. Thus, the price leader would not have an incentive to lower markups, although margins would be affected by competition in the form of advertised specials on meat.

Our indexes of prices of meat items sold to the poor indicated that the small chain was a price leader on such meat items, charging less than any other grocery for them. Moreover, meat-price indexes for meats consumed by the poor ranged from 97.45 to 124.18, with variations of over 100 percent on some items. Large chains and independents were arrayed rather evenly over the range. In contrast, grocery indexes had a range of 20 percent, and roughly one-half of the stores clustered between 98 and 102 percent of prices charged by the small chain. As mentioned above, this competitive leadership in prices on meat items sold to the poor has not eroded margins to the extent that they are as low as margins on meats sold to the average consumer.

One large chain set up a subsidiary chain with a different name to operate in the ghetto area of a large Northern city. If competition were keen enough, margins on meat sold to the poor could be reduced and volume of sales would then be the main determinant of profitability. Such a policy should result in higher sales within the ghetto, since the ghetto shopper would find lower prices on his market basket in the ghetto than outside.

In conclusion, this study shows that a standard market basket cannot be used to ascertain whether or not the poor pay more than higher-income groups for food. When the ghetto market basket differs from the standard one, and when it contains items which are priced as specialties by the stores outside the ghetto used for comparison, the poor pay more in terms of markups over cost on their market-basket items, even though all item prices are identical within and without the ghetto. This product-mix effect enables the ghetto grocer to price competitively and make a profit even though his costs may be somewhat higher than those of large chains.

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