Survey Finds Excessive Retail Profit On Fluid Milk Sales In Northeast US

Storrs, C.T.—A November 2006 survey of retail fluid milk prices in four states in the Northeast found that, at least in Connecticut, leading supermarkets are capturing an “excessive or windfall profit.”

The report was written by Ronald Cotterill, professor and director of the Food Marketing Policy Center at the University of Connecticut; and four graduate research assistants at the center: Adam Rabinowitz, Michael Cohen, Melanie Murphy and Charles Rhodes.

UConn’s Food Marketing Policy Center has checked retail milk prices annually since 2002. The 2006 survey area includes the three southern New England states, the Hudson river valley from Albany to the New York city line and suburban Long Island, NY.

Nearly all the fluid milk that consumers in southern New England drink is produced within 300 miles of their supermarket, according to the study.

Just in Connecticut, three fluid milk processors (Garelick Farms, which is owned by Dean Foods; HP Hood; and Guida Seibert Dairy) distribute more fluid milk for Connecticut consumers than 1,200 dealers did in 1946.

Garelick Farms alone distributes more than 60 percent of the fluid milk sold in Connecticut and the top three combined account for over 65 percent of all fluid milk sold, the study noted. Of these three, only Guida Seibert Dairy operates a fluid plant in Connecticut.

Garelick supplies southern New England from plants in Franklin and West Lynn, MA, and one in Rensselaer, NY. Hood’s main supply plant for the three southern New England states is in Agawam, MA.

This concentration in fluid milk processing into “very few very large plants” has produced huge gains in processing plant and route distribution efficiency,” the study noted. It means, however, that dairy farmers or their cooperative who would sell fluid milk in southern New England markets have only three primary buyers: Garelick Farms (Dean Foods); Hood and Guida Seibert.

Moreover, the primary fluid market for New England dairy farmers, and many farmers in eastern and central New York, is southern New England.

The retailing of milk has also undergone “massive concentration” since the 1940s, the report continued. Sales concentration has dramatically reduced the number of competing supermarkets in southern New England.

Increased seller concentration in the fluid milk processing and food retailing industries has resulted in significant cost savings through economies of scale in processing and scope in multi-product supermarket retailing. Such high concentration, however, “reduces the number of competitors, confers market power to the remaining sellers, and elevates prices,” the report stated.

“Three is the case in the southern New England market channel,” the report said. “Farmers on one end of the market channel and consumers on the other have experienced a significant windfall profit.”

The Northeast produced 15.57 percent of the US milk supply last year, up from 14.61 percent in 2005, 13.31 percent in 2002, 6.4 percent in 1990 and 4.4 percent in 1975.

The Southern Plains region produced 4.6 percent of the US milk supply, up from 4.34 percent in 2005, 3.89 percent in 2002, unchanged from 1990 and up from 3.7 percent in 1975.

Meanwhile, among other major dairy regions:

The Lake States region produced 21.38 percent of the US milk supply last year, up from 21.37 percent in 2005 but down from 21.55 percent in 2002, 26.7 percent in 1990 and 28.0 percent in 1975.

The Northeast produced 15.57 percent of the US milk supply, down from 15.98 percent in 2005, 17.17 percent in 2002, 18.4 percent in 1990 and 20.4 percent in 1075.

The Corn Belt produced 5.38 percent, unchanged from 2005 but down from 8.78 percent in 2002, 11.4 percent in 1990 and 13.6 percent in 1975.

The Northern Plains, Appalachian, Southeast and Delta States regions combined to produce about 8.7 percent of total US milk production last year.

California dominates the Pacific region, and last year its share of US milk production grew to 21.36 percent, up from 21.23 percent in 2005, 20.62 percent in 2002.

Meanwhile, production shares of the other major Pacific region states:

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Significant reduction in price competition."

Fluid milk retail price data used in the report are from leading supermarket chains, convenience stores, club stores, and limited assortment stores. The report's main focus is on the dominant distribution channel: supermarkets.

Dairy Technomics, a firm that evaluates processor plant and distribution costs for supermarket milk buyers, has provided the center with estimates of plant and distribution costs for individual plants and the brands distributed from these plants to each of the leading retailers in the region.

When combined with publicly available raw milk costs, researchers were able to decompose retail prices for particular brands of milk sold in particular retail chains into the retailer's margin, the processor's margin, and the price that farmers received.

This analysis allows one to determine exactly how the consumer dollar is split among the milk chain players: farmers, processors and retailers. Researchers also used estimates of supermarket retailers' in-store costs to identify the net profits of supermarket retailers by brand type and region.

Researchers also analyzed the effectiveness of the New York price gouging law, which forces retail milk prices down when farm prices drop to low levels. The factual evidence reported "suggests that southern New England states need a similar law to promote pricing efficiency and equity."

The report also documents the existence of "flat milk pricing"; that is, retailers charging the same price for whole, 2 percent, 1 percent and skim milk. Since the wholesale price of lower-fat milk is "much lower, this is prima facie evidence that supermarket retailers exercise pricing power in many stores."

"Competitive retail pricing would follow wholesale costs," the report said. "Flat milk pricing removes the economic incentive for consumers to switch to lower fat milk."

Retail Prices And Margins

During November 2006, processors paid farmers or their cooperatives $1.25 per gallon for the raw milk bottled. Fluid processors received, on average, 76 cents for processing and delivering milk to the chain stores.

Supermarket chains priced milk on average at $3.83 per gallon and kept $1.81 to cover their in-store costs, according to the study. This dollar gross margin is 47 percent of the retail price.

The Food Marketing Institute reports that the average gross margin for all products in US supermarkets is 27 percent. The 47 percent reported gross margin on milk in Connecticut is "excessive," according to the report.

Since milk is a very high turnover item, its percent margin should be lower than the average percent gross margins. Looking at the individual chains' margins for the individual brands of milk, researchers found "their pricing power is even more astounding." Stop & Shop, the dominant chain in Connecticut, has the highest prices.

"Stop & Shop pays Hood $2.08 per gallon for milk delivered to its stores and charges, on average, in its Connecticut stores, $4.62 per gallon for this Hood milk, the study reported. At this high retail price, "Stop & Shop retains a huge margin, $2.58 per gallon.""

Hood has established its brand franchise with consumers, but "Stop & Shop captures the lion's share of the brand's value," the study noted. "This is not an efficient economic arrangement because the company that creates brand value is not capturing the revenues due to that activity."

Similar pricing of Hood milk occurs at Shaw's and Big Y, but the retail margins are somewhat lower, at $2.09 and $1.97 per gallon, respectively. Similar margin performance was found for private label, Garelick and Guida milk in the top three supermarkets in Connecticut. Wal-Mart Supercenters in Connecticut (researchers checked three of the four) have "distinctly lower retail pricing." The study noted, Wal-Mart's retail margins are below cost on private label milk and less than half the retail margins of the other chains for private label and Garelick milk.

All retail milk prices, at an average $3.30 per gallon, are lower in Massachusetts than in Connecticut, researchers found. Processor margins and raw milk prices are essentially identical to Connecticut, so the lower retail price produces a significantly lower retail margin in Massachusetts, $1.34 per gallon.

Still, "this is far higher than the competitive margin of 60 cents," the report said. Excess or super competitive supermarket profits in Massachusetts are 74 cents per gallon.

In New York state, the announced threshold price was $2.72 per gallon in November 2006 for upstate. Price Chopper, Hannaford, and Wal-Mart complied with the law because they offered at least one brand (private label) at prices below $2.72. In fact, Wal-Mart priced all brands at or below the threshold. "This is not an efficient economic arrangement because the company that creates brand value is not capturing the revenues due to that activity."

For the lower Hudson River Valley, which is in the "downstate" retail price threshold area, the November 2006 threshold price was $2.94 per gallon. Three of the four chains offered one or more brands below the threshold price.

For four chains in Long Island, private label milk at three of four chains was exactly at the threshold price, with one chain slightly below. Prices and retail margins on Long Island were "significantly lower than in southern New England."

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