Supermarkets, loss leading and the relative price of alcohol

Kia ora koutou; welcome everyone to this session where we are discussing approaches to reducing alcohol-related harm through the use of pricing mechanisms.

For some time ALAC has become increasingly concerned that changing modes of alcohol consumption, types of alcohol consumed and places where that consumption takes place are negatively impacting on the usefulness of the excise tax as a harm reduction intervention.

In terms of alcohol prices, we think that one of the most significant developments worldwide has been the emerging dominance of supermarkets as major sellers of alcohol and the apparent promotion of alcohol as a *loss leader* by those supermarkets.

Our concern was that if supermarkets were indeed using alcohol as a loss leader, then this would result in a substantial downward trend in the price of alcohol and result in a lower relative price across all beverage types. In addition, we believe that the powerful position supermarkets now occupy in the alcohol market place is resulting in prices for alcohol being set by the supermarkets rather than the producers. As it is the producers who pay the excise tax, we are now contemplating if and how price can be used to ensure that *loss leading* with alcohol products either does not occur.

This presentation discusses the (**show slide**):

- Post-industrial, postmodern alcohol order and contemporary consumer drinking cultures
- Trends in the New Zealand (and global) alcohol market
- Impact changes in the alcohol market are having on the price of alcohol
- Impact on alcohol industry – producers and hospitality
- Brand NZ and brand Australia
- The free market – does it benefit the consumer when it comes to over all well-being?

The presentation will then look at alternative approaches to using price as a culture change and harm reduction and tool.

Post-industrial, postmodern alcohol order and contemporary consumer drinking cultures

Since the restructuring of the 1980's, New Zealand (and I suspect Australia) the assumption is that life's central purpose is economic production and progress is principally defined in material terms – a rising standard of living – and measured as growth in per capita income, or GDP. Growth is pursued in the belief that, overall it makes life better.

The acquisition and consumption of goods and services produced by the market economy, is central to life; the individual is placed at the centre of a framework of values, norms and beliefs celebrating personal freedom and independence; the ideological faith in the free market and choice is based primarily on economic considerations; and post modernism has seen grand narratives, universal truths and unifying creeds replaced by brands. Everything goes but nothing much counts - except the brand that the individual identifies with.

If a product is legal, it can and should be sold at a profit. The consumption of 'products' such as gambling, pornography and drugs, which may be relatively harmless in moderation but not in the excess, is promoted to ensure that consumers can maximise 'choice'. The consumer then makes a rational choice to maximise his or her utility of satisfaction and the market merely responds to consumer demand.

As Eckersley puts it in his publication 'Well and Good: Morality, Meaning and Happiness.' The risks of postmodernism include an 'anything goes' morality: a belief that values are just a matter of personal opinion, and that one set of values is no better or worse than another. Values cease to require any external validation or to have any authority or reference beyond the individual and the moment.

So, it is in this context that alcohol is promoted and sold.

Trends in the New Zealand (and global) alcohol market

I don't think what is happening in New Zealand is any different to what is happening around the world.

The alcohol industry is a global force these days with around five companies controlling most of the alcohol production and sales throughout the world. Competition between producers, retailers, and marketers on branding and pricing for the both the discretionary and not so discretionary dollar is fierce and is impacting on the price a producer can obtain for the product through to the price at a retail outlet – whether that be on or off-licence. Although 'brand' is important, price is the thing that is widely acknowledged as having the greatest effect on how much alcohol people will purchase. The palate clearly becomes less discerning as the price increases!!

In New Zealand we now have approximately 16,000 licensed premises – this includes the traditional on and off-licences as well as dairies, convenience stores and supermarkets. Supermarkets have, since 1989, become a major force in the alcohol market but they are now being joined by other megastores such as The Warehouse with its 'store within a store'.

This development has seen The Warehouse Cellars sublease a small portion of the Fraser Cove store in Tauranga from The Warehouse Ltd. The area is located adjacent to the grocery section in the existing *"The Warehouse"* store. It is of a similar layout to other aisles within the entire store. One end is blocked off to allow only one entry and exit to the licensed area. The business operates independently from *The Warehouse* store. It has a separate till system, separate EFTPOS systems, bank accounts, staff and so on.

While the company's original intention was to sell only beer and wine and, in particular, not the popular RTDs, this position has now changed and The Warehouse Cellars will be selling all types of alcoholic beverage. Under the Sale of Liquor Act no restrictions can be imposed by a district licensing agency or the LLA relating to the kinds of liquor that may be sold or delivered pursuant to this type of off licence.

The concern was of course that the move by *The Warehouse* would encourage the supermarket trade to enter the market in this way (a “store within the store”) in order to be able to compete on an equal footing with outlets such as *The Warehouse*. This has already happened in supermarkets in some regions.

It is also clear from statements made by the owners of supermarket chains such as Woolworths (Australian owned) that their expectation is that their New Zealand-owned supermarkets will apply the same pricing structure as that which applies in Australia.

This presents us with two very real issues: First, the minimum price of alcohol - the more competitive the market is, the lower the relative price of alcohol will become. And second, there is no legislation to prevent the sale of alcoholic beverages containing spirits. In fact, some supermarkets are already selling alcoholic beverages containing spirits through the “store with the store” approach.

So we turn to price and specifically, excise tax, to ensure that consumption at the least remains stable and at the best declines. But will excise tax work in the same way as it always have if competitors are willing to lose money because they can make their money back on the other commodities that they sell – such as groceries and toys?

In order to answer this question we commissioned some initial research to assess the penetration and impact of new retail outlet types on the liquor market in New Zealand.

Impact changes in the alcohol market are having on the price of alcohol - what does the research tell us so far about price?

As I said, the objective of the research was to make an initial assessment of the penetration and impact of new retail outlet types on the liquor market in New Zealand. Although the report is not fully we do have some initial findings to report that suggest among other things that (**show slide**):

- supermarkets have had an impact on the real price of some alcohol beverages but not all and
- per capita consumption of alcohol has been on the rise in New Zealand since 1997, having fallen considerably over the 1985-1997 period (supermarkets entered the market in New Zealand in 1989).

So far the research also tells us that (**show slide**):

- total beer consumption has been declining since 1987, although the rate of decline has eased since the late-1990s
- the average absolute level of alcohol per litre of beer consumed has risen from 4.01% in 1995 to 4.20% in 2006
- total wine consumption has risen considerably since the mid-1980s, with the rate of increase accelerating markedly over the last ten years.

- the real price of wine has declined by 15.2% over the 1988 to 2006 period[1], with a large proportion of this fall occurring between 1990 and 1991 (when the real price declined by 6%) coincident with the entry of supermarkets into the wine market in 1989.
- the real price of beer has continued to increase over the 1981 to 2006 period. Since 1988 the real price of beer has risen by 14% - with beer prices rising 77% compared to the overall CPI increase of 56%. The beginning of the sale of beer in supermarkets in 1999 does not appear to have noticeably changed the trend of the real price of beer.
- the entry of supermarkets into the wine market in 1989, impacted primarily on the share of other store types (mainly wine shop/vineyards and wholesale/factory shop/warehouses) in the sale of wine.
- the entry of supermarkets into the beer market in 1999 not only saw it quickly accounting for close to a quarter of all beer sales, but also provided a further boost to supermarkets' share of total wine sales (the 'foot traffic' argument).
- in recent years alcohol prices have been lower in supermarkets than in other stores by a factor of around 5% to 10%.
- measures for price elasticities of demand[2] for alcohol are difficult to establish - there are issues around time horizons over which consumer responses are measured. Nevertheless, the following seem tenable:
    - chronic drinkers: very low elasticity (i.e. very close to 0)
    - low to moderate drinkers: low elasticity (say, 0.5)
    - moderate to heavy drinkers: higher elasticity (say, 1.0)

The impact of alcohol prices being, say, 5% lower (than elsewhere) as a result of supermarkets could be depicted as (**show slide of table**):

Group	**Elasticity**	**Price**	**Consumption**	**$ spent**
chronic drinkers	0	5% lower	0 (no change)	5% lower
low to moderate drinkers	0.5	5% lower	2.5% higher	2.5% lower
moderate to heavy drinkers	1.0	5% lower	5% higher	0 (no change)

<u>Chronic drinkers</u>

This group represent those drinkers whose behaviour is not influenced by price changes. By implication therefore, this group's drinking patterns and level of consumption is, by and large,

[1] That is, adjusting for general CPI-measured inflation. In other words, wine prices, on average rose by 32%, whereas prices for all goods in the CPI rose by 56%.

[2] Price elasticity of demand is an economic measure of the responsiveness of the quantity consumed of a product to a change in the price of a product. If a small change in price results in a large change in quantity consumed, then that product is said to have a relatively high price elasticity of demand (i.e. demand is very responsive to price changes). Whereas, if a large change in price has little impact on the quantity consumed, then that product has a relatively low price elasticity of demand (i.e. demand is does not respond much to changes in price).

unchanged by the entry of supermarkets. However, the savings arising from the reduced spending on alcohol may result in increased consumption over time.

Low to moderate drinkers

This group characterises those drinkers who are mildly price-responsive. As a result of the lower-priced alcohol at supermarkets, this group increase consumption of alcohol. In addition, this group also takes advantage of the prices savings arising from supermarkets' entry by reducing the total amount (i.e. $s) they spend on alcohol - perhaps, using such savings to purchase other goods.

Moderate to heavy drinkers

This group is characterised by drinkers that have a 'set' alcohol budget (i.e. $s), and look to purchase (consume) a quantity of alcohol consistent with that set budget allocation. For this group the price savings arising from the entry of supermarkets is re-spent on further alcohol consumption, thus resulting in the largest consumption impact amongst these groups.

Brand NZ and brand Australia

Wine production in both New Zealand and Australia is viewed as important not only to the economy but also to the 'image' of both countries overseas adding value to our 'brands'. While this initial research does not give us a full picture of the impact on this 'brand', there **are** some clear implications for the wine industry in all of this.

- Total wine consumption has risen considerably since the mid-1980s, with the rate of increase accelerating markedly over the last ten years
- However, in New Zealand, the real price of wine has declined by 15.2% over the 1988 to 2006 period[3], with a large proportion of this fall occurring between 1990 and 1991 (when the real price declined by 6%) coincident with the entry of supermarkets into the wine market in 1989
- The entry of supermarkets into the wine market in 1989 has impacted negatively on the share of other store types in the sale of wine including specialist wine shop/vineyards and wholesale/factory shop/warehouses) in the sale of wine

What this may mean for the profitability of the domestic wine market in the future and the positioning of New Zealand as a quality wine producer internationally is yet to be investigated. Further research may help us to answer these questions but we suggest that this research needs the collaboration of the wine industry. If we are to get a truly clear picture, we need to have some idea of production costs and we cannot get this type of data without the industry.

Interestingly, the real price of beer has increased and the beginning of the sale of beer in supermarkets does not appear to have noticeably changed the trend of the real price of beer.

[3] That is, adjusting for general CPI-measured inflation. In other words, wine prices, on average rose by 32%, whereas prices for all goods in the CPI rose by 56%.

The free market – does it benefit the consumer when it comes to over all well-being?

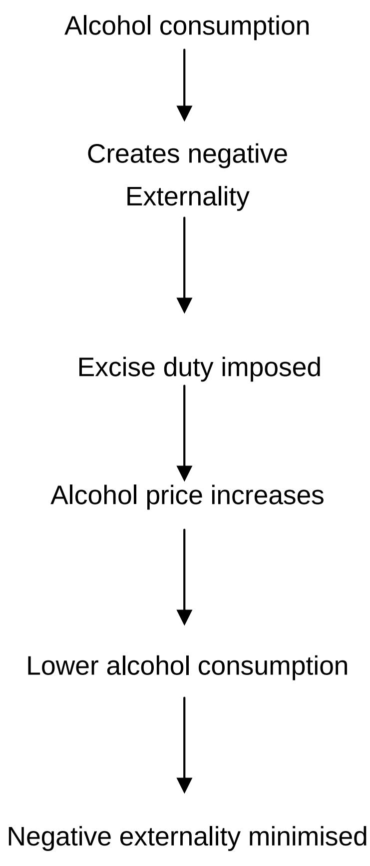
Of course supermarkets are only doing what they see as being in the best interests of both themselves and their consumers. Clearly, the ability to sell wine and beer has been very profitable for supermarkets otherwise they would not be investing in developing the ‘store within a store’ concept. This would allow them to market spirits and, given the impact the supermarkets have had on the price of wine, perhaps we can predict a fall in the real price of spirits if loss leading with this product is also seen as profitable.

I don’t think that I need to remind everyone here that the lower the price of alcohol the more alcohol people consume. What I am suggesting is that as researchers and policy makers, we need to do a lot more work on alternative approaches to influencing price and therefore consumption of alcohol. It is not sufficient to continue to recommend simply increasing the excise tax – this needs to be done in combination with other policy pricing mechanisms. In summary:

SUMMARY

- the rationale for intervention in the alcohol market is well-established given the presence of considerable (and measurable) negative externalities related to the consumption of alcohol.

Figure.1 The rationale for an excise duty on alcohol



- however, the entry of supermarkets has (to a degree) blunted the role, and impact, of the alcohol excise duty in minimising the negative externalities

Figure 1.2 The entry of supermarkets

Supermarkets entry

↓

Alcohol price declines

↓

Higher alcohol consumption

↓

Counters impact of excise duty

↓

Argument for further measures (policy)
to mitigate negative externality

- this provides a basis for looking at further measures (interventions) to ensure a balance between alcohol consumption and harm (negative externality) minimisation

Figure 1.3 Illustrative schematic of range of interventions

Policy options

Price-based	Regulation	education
e.g. additional excise duty	e.g. rules for the operation of stores; minimum purchase quantity; drinking age	e.g. advertising

Serious consideration needs to be given to further mechanisms to reduce harm. These could include:

- Minimum price
- Additional excise duty combined with a minimum price
- Regulation of store operation e.g. rules around amounts that can be purchased at discount prices

These are just suggestions - further work needs to be done and we will continue to do this.