

The Strategic Consultant Series

THE UPSIDE OF DOWNSCALE:

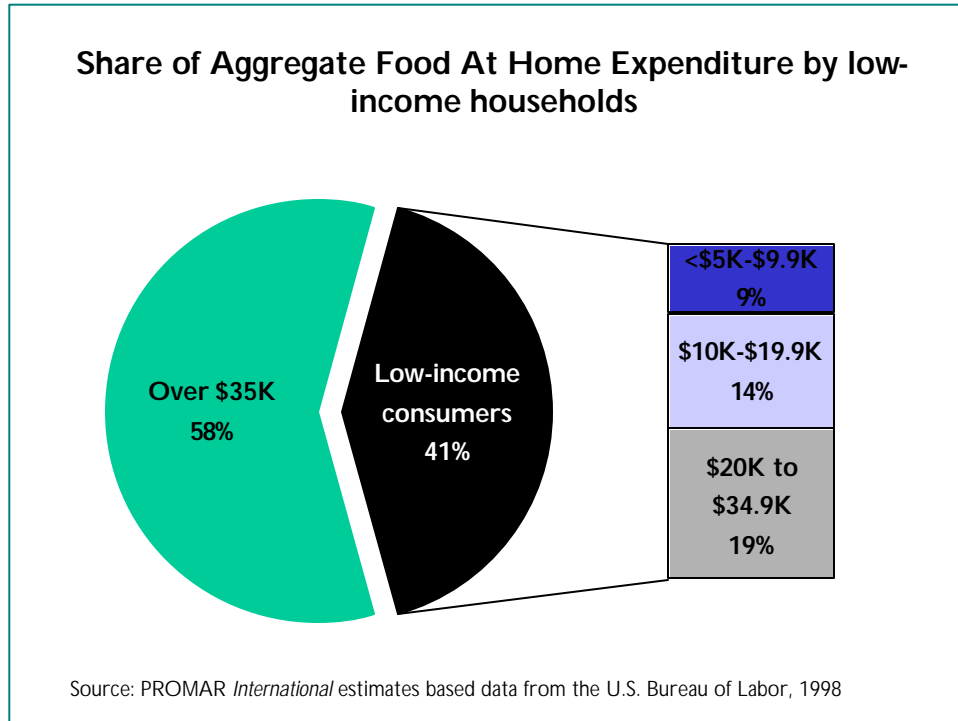
Marketing to low-income US food consumers
in the decade ahead

Publication: January 2001

Study completed. Please review attached sample pages.

THE LOW INCOME FOOD CONSUMER

Promar International has routinely pioneered strategic exploration of long-term growth opportunities within the food market. We were the first to author in-depth studies of such leading edge markets as nutraceuticals, ethnic foods, and organics. We continue that leadership with **THE UPSIDE OF DOWNSCALE**: Marketing to low income US food consumers in the decade ahead, which provides a practical framework for assessing the best ways to incorporate the needs of lower income consumers into an overall growth strategy for food and beverage companies.



Lower-income consumers represent over 45 percent of all food consumers and make up over 40 percent of retail food sales. Moreover, high growth populations, such as urban residents and Hispanics are disproportionately represented within their ranks. And unlike consumers with higher incomes, low-income consumers purchase most of their food for home consumption. Yet this large and powerful group of consumers is frequently overlooked by food marketers and often priced out of benefiting from key food innovations.

Can food companies afford to continue this neglect? **THE UPSIDE OF DOWNSCALE** evaluates how this consumer demographic will determine the fate of many brands—and potentially entire companies. Key to this assessment will be Promar’s expertise in evaluating the competitive opportunities for food companies. In particular, the study will profile market leaders and retailer pioneers, as well as assess the impact of changing regulatory and economic conditions. But most importantly, the study will provide direction for companies looking to develop and market innovative products that respond to this increasingly demanding consumer group.

KEY QUESTIONS

Assessing today's market

- How should the low-income consumer be defined? How are they different from their upper and middle-income counterparts?
- What is the buying power of today's low-income consumer? How sensitive to price constraints is this demand?
- How are food companies and retailers currently addressing the preferences of low-income consumers? What are the leading brands? What role does private label play?

Analyzing the drivers for change

- How will the changing food assistance landscape affect consumer demand and industry access?
- How are changes in food distribution influencing consumption by low-income consumers? Where will low-income consumers shop in the decade ahead?
- What will be the face of tomorrow's low-income consumer? How will immigration patterns and a shifting economy affect the composition of this consumer group?
- How will broader innovation within the food industry impact the expectations of low-income consumers?
- What is the level of demand for organics, nutraceuticals, and other high growth segments among low-income consumers?

Modeling tomorrow's market

- What will be the key points-of-value for tomorrow's low-income consumer?
- What types of manufacturers are best positioned to reach this powerful demographic?
- What is the outlook for specific product categories?

Developing your company's market strategy

- What pitfalls are companies likely to encounter when targeting low-income consumers?
- How should efforts to target low-income consumers be integrated with ethnic marketing programs?
- What are appropriate communication and distribution strategies for reaching low-income consumers?
- How can you ensure that your brands of today will appeal to tomorrow's low-income consumer?
- What are the implications for new product development?

Find the answers in:

THE UPSIDE OF DOWNSCALE:
Marketing to low-income US food consumers in the decade ahead

PROMAR CREDENTIALS

Problem solvers to the food chain

Since the 1980s Promar International has helped food, beverage and agriculture companies benefit from unfolding events in the marketplace. Our studies in ***The Strategic Consultant Series*** take an in-depth look at key areas where major change is occurring. They devote special attention to understanding the forces for change, identifying opportunities and threats, and, in turn, developing appropriate strategies. Designed for senior executives in marketing, research, planning, and management, these studies fill an important niche in the spectrum of resources available to companies.

The Promar perspective

Strategic analysis is one of the vital differences between Promar studies and the many boilerplate, off-the-shelf reports that dot the food landscape. While the latter offer some useful data, they do not provide in-depth market analysis or actionable strategies.

Promar's studies are also *focused on the future*. Our clients turn to us for more than a simple five-year projection: they want to know how the world is changing and how to position themselves for success. Our team of research analysts, economists, and marketing professionals devote three to six months to each study. The resulting work equips companies with the real world tools to achieve greater things – or simply make the right decision.

First-hand experience, first-rate reports

Promar is a top-tier consulting firm, not a publishing house that exists to churn out an endless series of studies. In fact, 80 percent of Promar's business consists of ongoing consulting and proprietary projects for companies spanning the food, drink and agri-food sectors. The research, analysis, and, most significantly, *understanding*, that is the product of this work informs our studies in a way that cannot be replicated by views from the 'sidelines.'

The company we keep

The value of Promar's work can be partly measured by our client list, which includes most of the world's largest branded food, beverage and agri-food companies—and by the fact that they return to us for additional studies and/or consulting projects. Reflecting the global aspirations and operations of the food chain, Promar conducts its work through offices in North and South America, Europe, and Asia.

PROMAR CREDENTIALS

Recent strategic studies

Our analysis of low-income consumers builds on the insight gained in researching several strategic projects.

Consumer behavior

- *Orienting the US food and beverage market: Strategies for targeting Asian Americans to 2010*
- *When they're 64: Profiting from the Baby Boomer food consumer to 2010*
- *The concerned consumer in the United States: Finding opportunities in anxiety*
- *New tastes and eating habits in the United States: Change, challenge, and opportunity for food manufacturers*
- *Food in South America: Changing consumers and markets present new opportunities*

Emerging sectors and industry issues

- *Reaping the cyber harvest: Implications of e-commerce for agriculture*
- *Food doctors: the future of nutraceuticals in the United States*
- *From Sub-culture to supermarket: Organic foods grow up*
- *Riding the US ethnic food tide: Strategies for food manufacturers into the new millennium*
- *Swimming with sharks: How mid-sized food and beverage companies can survive and prosper in an era of consolidation*
- *Japanese nutraceuticals, functional foods, and FOSHU*
- *Farmaceuticals and pharming: The value chain meets the biotechnology revolution*

Selected client list

- Baskin-Robbins
- Bayer
- Bestfoods
- British Sugar
- Cadbury-Schweppes
- Campbell Soup
- Carlsberg
- Chiquita
- Coca-Cola
- ConAgra
- Danone
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- Diageo
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- Heinz
- Hershey
- Kellogg
- Kraft Foods
- Monsanto
- Nabisco
- Nestlé
- Ocean Spray
- PepsiCo
- Procter & Gamble
- Quaker Oats
- Sara Lee
- Sadia Concordia
- Seagram
- Unilever
- United Biscuit
- Van Melle
- Warner-Lambert
- Zeneca

KEY PROJECT CONSULTANTS

Glenn Grimshaw

Analyst, Strategic
Marketing Group

Glenn is an experienced analyst with background in industry research from the Australian Department of Treasury and Union Bank of Switzerland (Australia). A graduate from Macquarie University in Sydney, he has both an honors degree and a bachelor's degree in Economics. Glenn recently researched and authored studies of supply-side issues in the market for organic foods, genetically modified foods, B2B operations in the food industry, and on the impact of consumer concerns on branded food demand.

Margaux Locklear

Analyst, Strategic
Marketing Group

As one of Promar's consumer specialists, Margaux has recently researched and authored studies on today's aging food consumer, future consumer demand for organic foods, and the market outlook for nutraceuticals in the United States. She graduated from The American University in Washington, DC with a degree in International Relations and Economics.

Don Westfall

Vice President

Don manages proprietary programs for Promar, which analyze the strategic implications of food trends and new products for clients. He has been in food and agriculture consulting for over 20 years. Earlier in his career, he headed market development for the State Department of Agriculture in Maine. Don has recently managed major studies of the organic and nutraceuticals markets.

André Williamson

Senior Consultant,
Strategic Marketing
Group

A senior consultant with years of experience in food market development, André has managed dozens of domestic and global market research projects, including several on consumer behavior and food distribution. André earned masters degrees in both Economics and Foreign Service from Georgetown University. His undergraduate degree was awarded by Princeton.

**STUDY CONTENTS
&
SAMPLE PAGES**

THE UPSIDE OF DOWNSCALE

Marketing to low-income US food consumers in the decade ahead

CONTENTS

MANAGEMENT SUMMARY

SECTION 1: LOW-INCOME FOOD CONSUMERS TODAY	1
1.1 Defining the low-income food consumer	1
1.1.1 Approaches to defining low-income households	1
1.1.2 Promar's approach to designating low income food consumers	4
1.2 Market power of today's low-income consumer	10
1.2.1 The low-income consumer population base	10
1.2.2 Food expenditures of low-income consumers	11
1.2.3 Retail preferences	14
1.3 Demographic profile of low-income consumers	17
SECTION 2: TODAY'S COMPETITIVE ENVIRONMENT	28
2.1 Retailers	28
2.1.1 Retail expectations of low-income consumers	31
2.1.2 Supermarkets	35
2.1.3 Mass discounters	44
2.1.4 Drug and convenience stores	48
2.1.5 Small grocers	52
2.1.6 Dollar stores	56
2.2 Food manufacturers	58
2.2.1 Economy foods	59
2.2.2 Trading up: The role of splurge purchases and heritage brands	72
2.2.3 Niche positioning: Ethnic brands and low-income consumers	73

SECTION 3: FORCES SHAPING TOMORROW’S MARKET	78
3.1 The changing consumer	78
3.1.1 Income	78
3.1.2 Demographic shifts	86
3.1.3 The changing consumer: Implications for food and beverage companies	92
3.2 Changes in retail	93
3.2.1 Industry relations	93
3.2.2 Retail consolidation	94
3.2.3 Fragmentation	95
3.2.4 Urban revitalization: Supermarkets revisit America’s cities	96
3.3 The new food assistance landscape	98
3.3.1 How food assistance programs influence low-income consumption	99
3.3.2 Looking forward: Drivers of change in food assistance policy	100
3.3.3 From welfare to work: The impact of The Personal Responsibility and Work Opportunity Reconciliation Act on food demand	102
3.3.4 Food stamps	103
3.3.5 Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)	106
3.3.6 Child Nutrition Programs	107
3.3.7 Changes in food assistance programs: Implications for food and beverage companies	109
SECTION 4: TOMORROW’S LOW -INCOME FOOD CONSUMER	111
4.1 Model of tomorrow’s low-income consumer	111
4.1.1 Determinants of food choice	111
4.1.2 Information acquisition and food choice	118
4.1.3 Income outlook: How budgetary perceptions shape low-income food preferences	121
4.2 Consumer types	124
4.2.1 The Content	125
4.2.2 The Disenchanted	126

4.2.3	The Downsized	127
4.2.4	The Investors	128
4.2.5	Unique sub-clusters	129
4.2.6	Putting it all together: Mapping consumer demographics and financial outlook	130
4.2.7	Consumer profiles	134
4.3	Low-income food consumption tomorrow	137
4.3.1	Macroeconomic performance	137
4.3.2	Growth populations	139
SECTION 5: STRATEGIES FOR TOMORROW		142
5.1	Strategic context	142
5.1.1	The long-term significance of low-income consumers	142
5.1.2	The costs of targeting low-income consumers	146
5.2	Strategies	147
5.2.1	New Product Development	147
5.2.2	Communication based strategies	153
5.2.3	Distribution-based strategies	156
5.3	The prospects for branded food and beverage companies by product category	163
5.3.1	Bakery products	164
5.3.2	Ready-to-Eat Cereal	165
5.3.3	Non-alcoholic beverages	166
5.3.4	Frozen foods	167
5.3.5	Dairy	168
5.3.6	Snacks	170

SECTION 1: LOW-INCOME FOOD CONSUMERS TODAY

Defining the low-income food consumer

As the figure above indicates, consumption-based income classifications are used to determine the likely purchasers or consumers of a given product. As everyone consumes food, there is little use in identifying likely purchasers of food overall. Consequently, “likely purchasers” become important only when evaluating who is likely to purchase a given product category or brand. Identifying low-income consumers becomes a matter of isolating the income point where the most significant shifts in food consumption and purchase occur.

We have identified two major income-related behavioral shifts in food consumption: overall food security and the proportion of food expenditure devoted to food away from home. In both these cases, the shift occurs approximately the same income range – \$30,000 to \$40,000. Other behavioral differences such as brand loyalty, store preference, and the use of money saving tactics (e.g. clipping coupons) do not correlate as significantly to income and will be discussed later when we more closely examine the different types of low-income consumers.

a) Food security

Food security means the ability of shoppers to purchase on their own a minimum basket of food products. In 1998 nearly 10 percent of Americans did not have secure intakes of food. Of those about one-third or 3.5 percent of the US population go hungry. Meanwhile the share of US households receiving food stamp benefits is just 7.3 percent. As these figures would suggest, not all food insecure households are receiving government aid.

Food insecurity vs. hunger

Food Insecurity exists whenever the availability of nutritionally adequate and safe foods or the ability to acquire acceptable foods in socially acceptable ways is limited or uncertain.

Hunger, in its meaning of the uneasy or painful sensation caused by a lack of food, is in this definition a potential although not necessary, consequence of food insecurity.

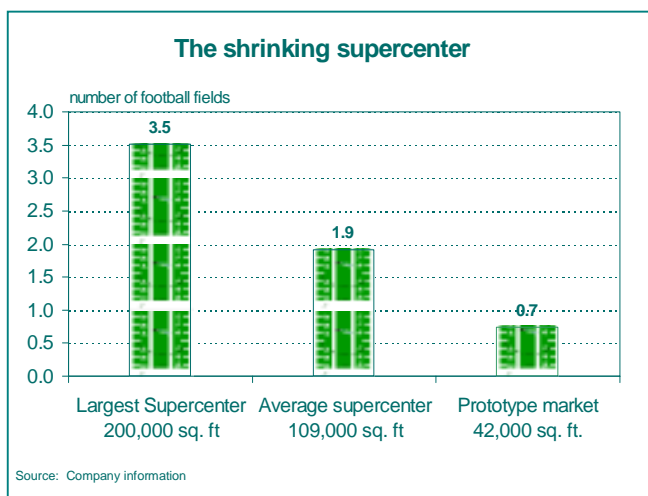
Source: Expert Panel of the American Institute of Nutrition working with the Life Sciences Research Office

To get a better idea of who would fall into this category, we reviewed the eligibility requirements for the various government sponsored food assistance program and took a look at their relationship to annual poverty guidelines. The largest ratio was 185 percent. In 1999 for a four-person household this would equal approximately \$31,500. However, much of the research sited through the SIPP program noted that households with income to poverty threshold ratios higher than this are likely to find themselves in need of food assistance at some point. Using a conservative measure of 200 percent of the poverty threshold, gives us a food security breaking point of \$34,000 for a family of four. The following chart details in greater detail the relationship between the eligibility criteria for the various food assistance programs and the poverty threshold.

\$40,000) form the majority of the customer base for the other two top discounters – Target and Kmart. Still, Wal-Mart has aimed to be the *retailer of choice* for all US consumers, not just those with lower incomes. Most of its key initiatives in terms of branding, store development, and pricing will appeal to consumers having a broad range of incomes.

Still several recent initiatives, while not exclusively targeted toward low-income consumers, suggest that the company's position among low-income consumers is likely to improve. First, the company is planning on expanding the number of *Neighborhood Markets* it operates. Developed as a smaller alternative to Supercenters, Neighborhood Markets average 42,000 sq. ft. (excluding parking lots) in size, but still offer a full line of grocery items. Wal-Mart has described the smaller Market format as providing greater "flexibility to serve markets where we may not have a Supercenter due to demographic or real estate constraints."

Clearly, urban and low-income areas are likely to benefit from this sort of expansion. Second, Wal-Mart is planning on expanding its private label offerings. Supplementing this expansion, Wal-Mart has launched a private label credit card. Third, the chain is in the process of developing stores in several central city locations. And finally, Wal-Mart is changing its merchandising efforts toward a "Community Store Concept" in which products sold in stores vary according to community characteristics.



Low-income appeal by store format

Format	Food sales	Income level
Traditional discount store	Food centers are always located at the front of the store. Milk, bread, and eggs are standard, plus they offer an extended selection of dry groceries and refrigerated foods. Food center sales have been increasing 10% – 15% annually.	Up to \$60,000
Supercenters	After two years of operation, grocery volume accounts for about 30% of store sales or on average \$19.5 million per store.	\$25,000 to \$75,000
Neighborhood markets	40,000 Sq. ft conventional grocery stores with drive-through pharmacies. SKUs equal about 80% of a standard supercenter.	\$25,000 and over
Sam's Club	Warehouse/club store	\$45,000 and over

Key challenges

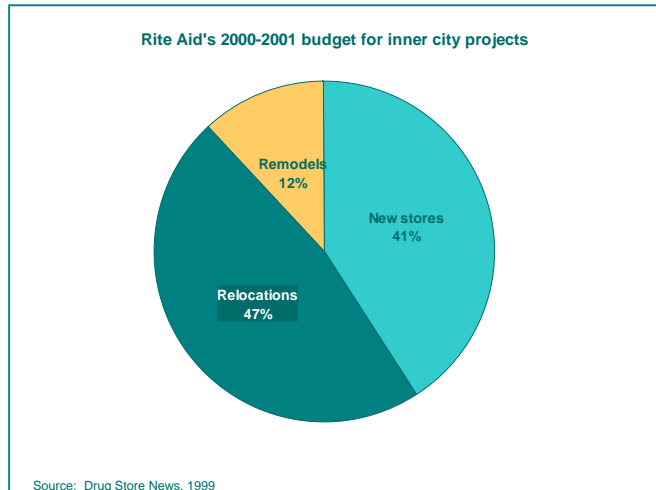
By challenging the conventions of food retailing, Wal-Mart has earned the somewhat reluctant respect of supermarket operators. However, the company has also earned the ire of consumer groups, environmentalists, and small businesses along the way. The size of the Wal-Mart stores has drawn particular criticism. Its largest Supercenters are as large as three and a half football fields (excluding the 200,000 sq. ft. parking lots). Community opposition to the size of supercenters is part of the reason why the Market concept was developed.

On the international front, Wal-Mart is quickly earning a position alongside McDonald's as a symbol of US cultural dominance in an era of globalization. Yet despite this reputation as a

Rite Aid – testing the limits of downscale

Rite Aid is the third largest drugstore chain in the nation. In an attempt to improve its position vis a vis the two leading chains – Walgreen and CVS – Rite Aid has engaged in a strategy of rapid store expansion. Since 1996, the company has added over 1,300 new stores.

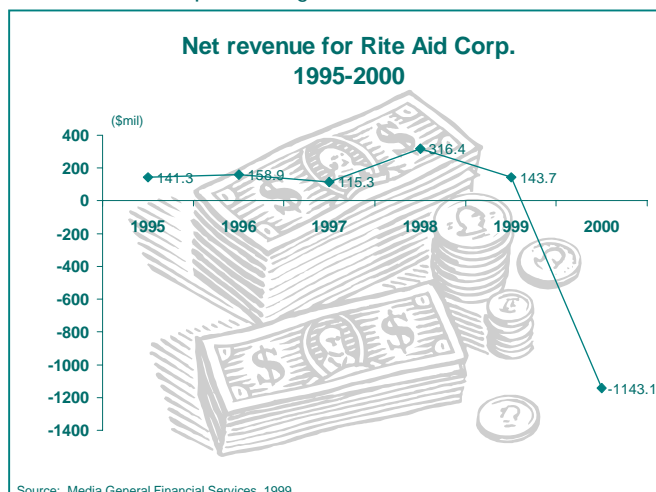
Key to Rite Aid's growth strategy has been the acquisition of Thrifty PayLess. With over 1,000 stores, the discount retailer was the largest chain on the West Coast until Rite Aid purchased it for \$2.3 billion. In addition to giving Rite Aid – a chain whose stores were mostly on the east coast – a west coast presence, the acquisition also strengthened Rite Aid's discounter positioning.



A pivotal component of Rite Aid's store expansion has been its commitment to building and maintaining stores in low-income—particularly inner-city—areas. In 1999, the company estimated that 630 or just over 16 percent of its 3,853 stores were located in “economically distressed neighborhoods.” Reportedly Rite Aid has also committed about \$380 million to relocate, remodel or build 135 inner city stores during the 2000 and 2001 fiscal years.

Despite the company's retail expansion, Rite Aid faces considerable problems. Since its share price reached a high of \$15.13 in 1999, the value of Rite Aid's stock has plummeted some 85 percent. And beginning in July 2000, Rite Aid – the worst performing stock on the S&P 500 in 1999 – will be replaced on the stock index by JDS Uniphase.

An assortment of troubles, including a \$1 billion readjustment of profits for FY 2000, a suit claiming that Rite Aid charged uninsured customers more for prescription drugs, and an announcement of over 850 layoffs has led to the resignation of Martin Grass of Rite Aid CEO and placed the viability of Rite Aid's expansion strategy into serious doubt.



Grass, the son of Rite Aid's founder Alex Grass, was one of the lead proponents of Rite Aid's expansion into inner city markets. As early as 1998, the former CEO had gone on record in support of Rite Aid's urban expansion. With his removal it is unclear how Rite Aid will view low-income areas in the future. The chain may, for example, choose to improve sales by improving its presence in such high-end sectors as dietary supplements. Rite Aid's partnership with General Nutrition Companies (GNC) to open vitamin

Calculated as the percent change in quantity demanded divided by a given change in price, price elasticity of consumer demand measures the responsiveness of consumer demand to a price change. When we look at the broader food categories, such as dairy or fresh vegetables, most foods are price inelastic – meaning that as price increases demand for foods within the category declines very little. When we look at more narrow product categories, especially among more highly processed foods, this is not necessarily the case. For certain status foods, for example, demand may actually increase with prices. But on the whole, price responsiveness increases as product distinctions become subtler (decreasing the relative importance of each good in consumers' budgets) and the realm of product substitutes expands.

Percent change in quantity demanded following a 1 percent increase in price	
Food group	Own-retail price elasticity of consumer demand
Beef & veal	-0.065
Pork	-0.745
Poultry	-0.607
Eggs	-0.064
Dairy	-0.974
Fresh fruit	-0.208
Fresh vegetables	-0.054
Source: USDA	

Price elasticity is difficult to use when determining the price positioning of categories. First, there is little agreement on product categories. Depending on how categories are defined, elasticities can vary significantly. This problem is further compounded when we consider cross price elasticities or how price changes affect the demand for two related goods. Second, while price elasticities give us an idea of whether price is important, it does not indicate the importance of price relative to other consumer concerns such as health or comfort.

Still, we can make some generalizations about categories where value for money is a dominant consideration. To better classify food categories we selected three key indicators of economy categories: product differentiation, evidence of private label penetration and economizing behavior.

Economy categories are less differentiated

Among more differentiated categories, such as prepared meals and snacks, price plays a lesser role than other product attributes. With less differentiated foods and commodities, such as flour and milk, price is a primary determinant of brand choice.

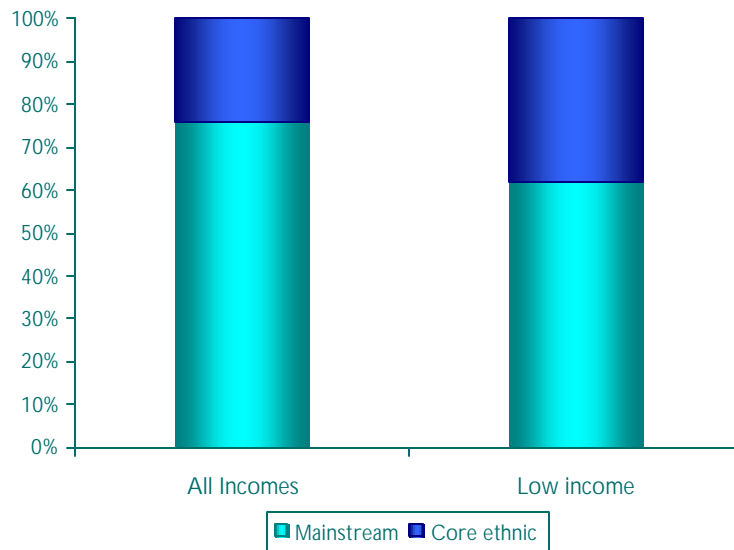
Image-based brands can be a critical exception to this relationship. With products such as soft drinks, cigarettes, and beer there are few noticeable differences in product quality or attributes between brands. The leading brands in these categories have strong lifestyle based images that serve to differentiate products and lessen the role of price.

Beyond this *Core* group of ethnic consumers are *Mainstream* ethnic food consumers whose share of ethnic food consumption increases over time. *Mainstream* consumers fall into the following five broad groupings based on their frequency of consumption and attitudes towards ethnic foods:

- **Enthusiasts** love to explore different cultures by trying new and exotic cuisines.
- **Experimenters** enjoy trying unfamiliar dishes; they see the untried as an adventure.
- **Moderates** are a timid bunch who enjoy ethnic foods that have been toned down to fit the tastes they are used to.
- **Traditionalists** find the unfamiliar somewhat intimidating and tend to shy away from ethnic foods, especially the more exotic cuisines.
- **Avoiders** only enjoy foods that they are familiar with and have no interest in ethnic cuisines.

Ethnic brands have particular appeal to low-income food consumers. As noted in Section 1, African-Americans, Latinos, and Asians are disproportionately represented among low-income food consumers. We have adjusted our original segmentation of the ethnic food consumer base to reflect this high representation.

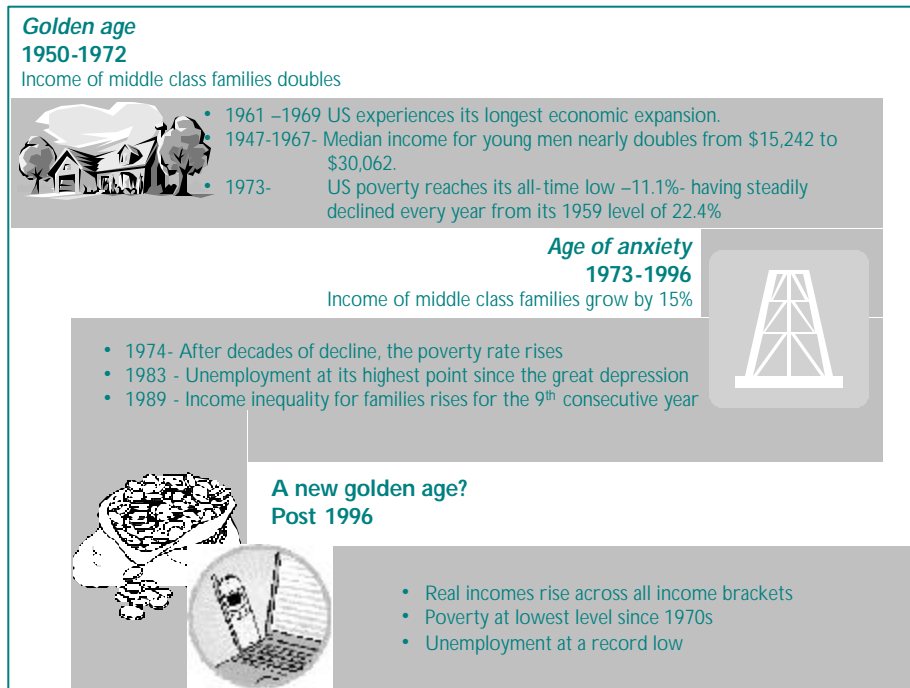
**Proportion of Core and Mainstream ethnic food consumers
low-income vs. upper-income households**



Source: Promar International

SECTION 3: FORCES SHAPING TOMORROW'S MARKET

The changing consumer



But how, if in any way, will these broad macroeconomic shifts affect the food spending of low-income consumers? Will low-income consumers approach the economy (and consequently their spending) with a new sense of optimism? Or do those with lower incomes feel excluded from the current economic prosperity? To more fully understand the implications of current economic growth (and conversely a potential downturn) we must first explore the relationship between income and food spending.

The relationship between income in hand and spending is proven and readily understood. To state that a shopper's food spending is constrained by his or her budget is to state the obvious. Less apparent, however, is how changes in the way consumers perceive their incomes affect their budgets and ultimately their food spending. That is, how does food spending vary when a consumer changes her income reference point? To better understand this relationship, we have categorized how consumers view their incomes into two broad categories: temporal comparisons and distribution comparisons.

Temporal comparisons simply refer to comparisons consumers make between their present income, their past income, and their anticipated future income. Assuming that consumers will exclude from their budgeting process unexpected and transitory earnings, such as an inheritance or a project based on an increase in overtime, consumers will primarily base their spending behavior on their **permanent income**. That is, increases in spending are based on expectations of permanently increased future earnings. In turn, anticipation of a permanent decline in future earnings can prompt consumers to economize.

Impact of reforms on food demand

Economy wide impacts on output of a \$23 billion decline in FS benefits		
Sector	Percent change	Absolute change
Farm	-0.2 and 0.2	- \$1 to \$ 2 billion
Food processing & distribution	-0.15 to -0.3	- \$1 to \$2.5 billion
Service sectors	-0.02 to -0.03	- \$3 to \$6 billion
Construction	+0.25	+ \$2 billion
Durable manufacturing	+0.1	+ \$2.3 billion

Source: Economic Research Service/USDA. 1999

The Congressional Budget Office estimates that the net result of these declines in food stamp enrollment and benefit levels would be a \$23 billion drop in Food Stamp outlays between 1997 and 2002. The impact of these declines on food demand, however, is likely to be much greater. **As a result of the drop in food stamp outlays, USDA projects a \$5 to \$10 billion decline in retail food**

sales between 1997 and 2002. Since, food stamp benefits free up funds to be spent on other needs, the USDA also projects a \$13 billion to \$18 billion decline in non-food retail spending over the same period. The adjacent table shows how such a decline in consumer spending would affect output in key sectors such as agriculture and food processing.

Declines in food stamp outlays may also impact demand for specific foods. In general low-income consumers experiencing declines or the elimination of their food stamp benefits are expected to reduce their overall food spending as well as shift spending toward less-expensive goods. Because low-income consumers spend a disproportionate share of their food dollars on meat (approximately 1/3), this category is likely to experience the sharpest declines.

3.3.5 Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)

The people eligible for WIC benefits include pregnant and postpartum women and infants and children up to 5 years of age. Unlike Food Stamps, WIC is not an entitlement program. Congress sets its funds annually. Furthermore program vouchers can only be redeemed for specific foods that are nutritionally important. As a nutrition program (as opposed to a food program) WIC also provides participants with nutrition education, health care referrals, and immunization screening. In 1992 the program was expanded to include vouchers for foods that can only be purchased at farmer's markets.

WIC approved food categories

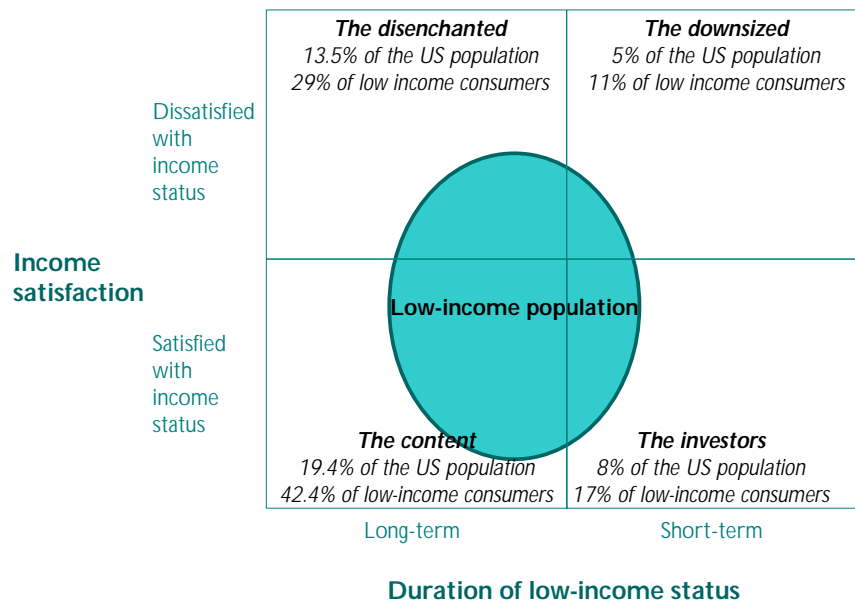
- Iron-fortified infant formula
- Infant cereal
- Milk
- Cheese
- Eggs
- Iron-fortified breakfast cereal
- Fruit or vegetable juice
- Dry beans
- Peas
- Peanut butter

4.2 Consumer types

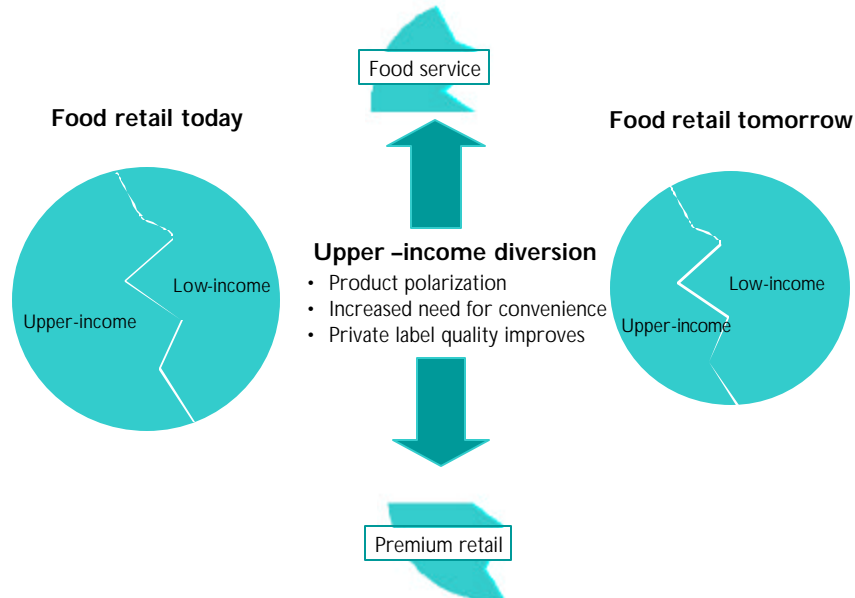
How consumers view their financial situation says a great deal about how they will tend to prioritize their value points and their likely food knowledge. To explore these relationships more fully we have classified low-income consumers according to their level of financial satisfaction and how long they expect to remain low-income. Our resulting consumer types are the *Disenchanted*, the *Downsized*, the *Content*, and the *Investors*. Where a low-income consumer falls within this framework can denote key differences in his/her:

- Consumption preferences,
- Retail preferences, and
- Economizing efforts.

Financial outlook among low-income consumers



Low-income food shoppers: Today and tomorrow



At the company level, the importance of low-income consumers depends on a variety of factors including the category (or categories) it operates in and the income distribution of its consumer base. But in the decade ahead forces will combine to increase the importance of low-income consumers for food companies overall. Moreover, they will shape the approaches food companies take in marketing to low-income consumers. The most significant forces include: a more varied and accessible retail environment and a more fragmented base of food consumers.

a) A more accessible retail environment

Low-income consumers will continue to experience greater access to quality food retailers as they benefit from two interrelated trends. First, more non-supermarket players have begun to compete in the grocery market. Second, supermarkets are seeking growth in urban, rural, and other underserved locations. Amidst this opportunity to better reach low-income consumers, the trends that promote increased retailer access also present a set of challenges to food manufacturers.

Supermarkets aim at underserved communities

As we detailed in Section 3 of this study, supermarkets chains like Pathmark and Safeway are setting their sights on the inner city and other underserved communities for new store locations. In addition to serving a social good (policy makers and local activists have long argued that inner cities need more supermarkets) the trend is also a response to competitive pressures. As

5.3 The prospects for branded food and beverage companies by product category

We have discussed the significance of low-income consumers in the aggregate (their overall importance to the food industry), but when we move from the aggregate to the particular their importance varies. At the sector level, for example, at the high-end low-income consumers account for 49 percent of all egg sales, but only 39 percent of fish and seafood (low end). Food companies will necessarily view low-income consumers differently depending on the sector in which they operate. Category considerations will further shape a company's ability to tap the full low-income opportunity. This section reviews the constraints and opportunities presented by six broad sectors or categories of the food industry, including:

- Bakery products,
- Ready-to-Eat Cereal,
- Non-alcoholic beverages,
- Frozen foods,
- Dairy, and
- Snacks

While there are factors unique to each category, certain factors appear relevant across several categories. On the consumer side of the competitive environment, categories vary significantly in their ability to respond to key changes in household demographics and consumer lifestyles. As a consequence, manufacturers will vary in the degree to which they can meet low-income consumers' demands for greater convenience, indulgence, and value. The relevance and responsiveness to key industry trends in distribution, production, and product innovation will also differ across categories.

For each category we will denote both the relative significance of these forces for change and the category's readiness to effectively tackle the challenges and opportunities they create. Using a five-star scale (1 = low, 2 = high) we denote the relevance of the following basis of competition for each product category:

- Price,
- Convenience,
- Indulgence,
- Innovation,

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