

What Happens Next – 7.11.2021
Literature, Creative Destruction and Supermarkets
Benjamin Lorr QA

Larry Bernstein:

I want to talk about my first job, I was a runner at the Chicago Board of Trade and I was participating in an ecosystem for commodity futures. And one of the interesting things about the Chicago Board of Trade, I'll just pick one contract, which is the Wheat contract, before the board of trade was trading, Wheat futures, Wheat would be sold from a particular farm to be delivered to a specific place. And the board of trade defined what Wheat was, a certain quality, a certain quantity, and then it could be traded on a futures contract. And that led to the commoditization of Wheat, commoditization of corn, et cetera. But when I look back at that 150 years since the Chicago Board of Trade Instituted those commodity futures, it's, I think one of the greatest things ever accomplished in the commoditization of food. It allowed for hedging. It allowed for specification, as you described it, should we glorify the commoditization of food because it allowed for the most incredible productivity in history?

Ben Lorr:

I guess I would, I would try to avoid the binary cause I don't think it's very helpful. It is. It absolutely is responsible for what I'm calling this miracle here, not just in the financial sense of, of creating markets that are tradable and you can hedge on, but in terms of the production angle and creating consistency and regularity there, you can't have industrial supply without industrial regularized, regular components.

Consumers certainly expect that type of uniformity. On the other hand, it comes with these fairly negative consequences. And I think when the scale gets to a place where certain notions that I think may have been baked into the commodity system 150 years ago are no longer baked in, in terms of, or maybe people just didn't care about in terms of standards of living and wages and decency and, and, and you know, forced labor through violence. It's actually an open question, I guess, whether 150 years ago, those, those were even on the docket of discussion, but I think the march of progress, we'd like to think that there's something we do care about. The problem is the anonymizing qualities of commodity and enable these kinds of darker things to creep in, in the side.

Larry Bernstein:

Let me try a different route. You have a chapter in your book on Trader Joe's and I thought it was great. And in it, you talk about how Joe moves away from standard generic standard corporate brands and goes out and tries to build his own brands internally, , finding specific coffee with a story, finding a specific salad dressing with a story. It might be based on tastes based upon whatever, where it's from, how it's made or even its high wages paid to the employees. How do you think about Trader Joe's as an example, of working towards the very goals that you're describing?

Benjamin Lorr:

I think in the mid-1960s when Joe was making this, he's doing exactly that. Although I think he would be the first to acknowledge all the trade-offs that he was accepting in doing so, Trader Joe's at that time had about 1,500 SKUs. The typical grocery store of that era had about 3,500. Now, we're north of that, considerably. And you'll go to these bigger superstores will have 125,000 SKUs. So he was able to find those values and able to zoom in on products that he could look at with more of an individual lens and not play the continuous goods game by shrinking down his offerings, by creating a buying staff that didn't have to deal with that waste and a warehousing staff.

And in some ways, it took Trader Joe's a long time to climb to a national chain. This was in the mid '60s. It didn't become a national chain until the mid '90s, at least, and they had to start steering back in the other direction and they've kind of found a compromised version, which again, I guess is to say those opportunities are there. They come with compromises. No one's doing all their shopping at Trader Joe's, especially not in Joe's day, when he was doing those type of innovative things. I mean, I think he removed all paper towels and lots of things you'd expect to find at the grocery store.

Larry Bernstein:

I want to go back to what you described as the miracle of the grocery store for a second. I remember a story, I don't know if it's true, that when Gorbachev came to visit the United States, that Ronald Reagan, I think the first thing he did was take him to a grocery store to show him what choice, and plenty, looked like. And Gorbachev was absolutely, flabbergasted at the lack of lines and couldn't believe it was actually true. Do you know this story?

Benjamin Lorr:

Totally. It was actually was at a Randalls supermarket in Texas and he was touring, I think, an aerospace facility, but they stopped off, no doubt intentionally, during this tour at the Randalls and he was pretty staggered by it. And in fact, in his private diaries, he wrote something like, "I have great despair if the Soviets ever see this because they would immediately revolt. It was an actual jarring moment for him in his private memoirs because ... And at first, there was this idea that this was a dog and pony show and it kind of dawned that, no, this is how the food system worked on a regular basis.

And yeah, I think that's exactly right. That miracle is really important to take into account, I think, when considering the downsides of it because, when thinking about how much of this thing that really stretches our credulity as to whether it's possible or not in recent past, it's possible that we have overreached. And I think that we're not going to walk that back by limiting expectations. That genie is kind of out of the bottle, but I think we need to think about ways to reform that system.

Larry Bernstein:

Earlier in my conversation with Philippe, I mentioned Amazon as a constant topic of conversation for the show. And Amazon acquired Whole Foods. What are your thoughts on

how Amazon will use and reform or modernize Whole Foods, or not, in the context of SKUs and other ways to improve the grocery shopping experience?

Benjamin Lorr:

Oh, it's a great question. Whole Foods, in many ways, is a victim of its own success. They were really innovative in the organic space and the whole first space early on and they nurtured a lot of brands. And they did that by being very decentralized, very nimble, putting a lot of their resources into local buyers who would get to know these smaller products. And it produced a lot of success, but then as they grew and as those brands grew and as organic became the seat change that became an ever bigger share of people's pocketbooks, those brands scaled up pretty easily. And Whole Foods, the amount of money they were taking to nurture these brands became wasted as the brands would jump over to Targets or Walmart's pretty easily. And Whole Foods was not centralized buying in a way that could compete with it.

So way pre-Amazon, Whole Foods was rethinking how it could play this game and centralized out. And I think, with Amazon, it was acknowledgment of that strategy that it was not going to innovate on a small level and do what we were talking about with Joe. It was going to stay pat and try to play into its existing brand image of whole earth, some people call it whole paycheck, but premium prices with some virtue that you're getting as a consumer when you buy from them in absolute, and not really try to innovate in that space anymore, but instead try to play with the other big boys, Walmart now being the number one purveyor of organics.

So I think you're going to see a continuation of that strategy with Amazon because, obviously, Amazon brings a huge amount of expertise with logistics and whatnot.

Larry Bernstein:

Let me try to bring in Philippe. Philippe, you were talking about trying to prevent colossal firms through mergers from getting into new businesses. For me, this is a classic example of a difference of view on antitrust policy. Amazon had no grocery presence. It buys Whole Foods and is going to try to reform it, but I think the Biden Administration would say, "Whoa, whoa, whoa. You're big enough Amazon. We're going to prohibit you from growing in the grocery business." How do you feel about Amazon's growth, from a public policy standpoint, from getting in the grocery business and allowing increases in scale?

Philippe Aghion:

Well, it's true that you can have what you call economies of scope or economies of scale, but the problem is that that may stifle subsequent innovation. You see, that's the fear, because the scale may be so large. So it's true that there is a short-term gain, which is the scale and the scope, but the question is, will it or will it not stifle future innovation? Maybe in the sense of that, you could have had entry. Maybe new entrants would have come. You see what I mean? And there may be, as a result of this, they won't because they will be discouraged by the lost capacity of the incumbents. You see, that's the kind of things that ... Again, competition policy is not my specialty. Usually that's people like Gilbert or others, but I think those are the kind of issues.

Larry Bernstein:

What do you think about Ben's other comment about policing the supply chains? And should society expect grocery chains or, for that matter, the food manufacturers from policing wages and other matters related to the product of food, or does that really belong with the state and it's not the grocer or the food manufacturer's responsibility.

Philippe Aghion:

No. And although there is the old issue of corporate social responsibility, because you could have the Friedman view that firms should just be about maximizing profit and you should let the state decide about contracts or regulation, but there is some other view that there is the role for shareholders and consumers and also pushing for some changes. You see what I mean? And so that's the whole debate. We are moving away from the Friedman view that firms should just be concerned by profit and that anything else should be in the hands of the state, if only because we know, and that gets back to my point about the triangle, that the state and the regulators can be captured by large firms.

And so that's where there is a role for corporate social responsibility, for consumers, for shareholders that are concerned about something else in addition to profit.

Benjamin Lorr:

I don't think grocers have a responsibility, necessarily, to police their supply chain. What I think is that, given the scale, there's an unavoidable lack of transparency that happens. And what we need is innovation around that transparency. What we need is ways of creating that visibility through.

And it really dovetails to this Amazon/Whole Foods discussion right now. There's a lot of ways to innovate and very important ways to innovate around the supply chain in terms of workers' living conditions and standards, and we haven't even talked about ecological sustainability, but the problem is the visibility isn't there. Consumers have a very static view of how these things change. They're looking through many layers of this and it's just blurry and hazy.

And there's a disconnect between what they think they're getting and what is actually happening. And that disconnect is the problem. Who actually polices it, I'm very agnostic about it. It just needs to get done. And I actually think, to your point, that grocery stores are one of the worst in terms of being able to do that policing. They're not equipped for it. Nation states are far better at it.

Larry Bernstein:

I want to bring Angus into the conversation. Angus, in the late 1990s, I lived in London. And at the time, London's food quality was relatively poor and the people didn't expect much from their food suppliers or their restaurants, but since then, London is now completely a foodie town and England has much better food. I'm wondering about the neuroscience of food. When Ben was talking about the relative numbers of ... I can only imagine going to a general store in 1900 in rural Kansas and looking at the choice offerings that were available to me as compared to the 125,000 SKUs that Ben was saying was available in a modern mega supermarket. How

does neuroscience explain the differences of choice, differences of quality, the breadth, and then the experience that we have, as humans, to all this choice and all these improvements in quality and breadth?

Angus Fletcher:

I think the paradox is, that the two earlier speakers have talked about, on the one hand, humans have created that diversity of choice in a supermarket because that's innovation. I mean, all of us want more and it's exciting for us to go to a supermarket and discover something new in a supermarket, and the same reason it's exciting to discover a new book on a shelf. So there's this constant drive for more products, more innovation, more choice, but the flip side of that is that the human brain cannot handle choice. The human brain is not like a computer. A computer can handle thousands and thousands of data points in a second. The human brain gets swamped out after about six or seven data points and then it just starts to cramp up.

What happens is we create that choice because it's exciting, but then when we get in the supermarket, we immediately get overwhelmed. And most people in the supermarket just go to the three or four things that they know they want to buy and just ignore everything else because, otherwise, it's panic inducing. And if you've ever been in that situation where you're in a strange supermarket or you're looking for something where you don't know where it is, I mean, it is kind of like this Kafkaesque vertigo experience where you're completely overwhelmed.

This is just another example of the way that creative disruption works, in the sense that we have generated this thing, which on the one hand is very exciting in its generation process, but then very rapidly does have this kind of darker side to it. So I think, as in all things in human life, it comes about from not romanticizing it or from demonizing it, but basically saying, "Hey, the fact that supermarkets exist is the sign of an enormous creativity and innovative potential in the human mind. Now, let's train that on solving the problems around us."

The way to solve problems is local. None of us can solve big problems. And I know it's attractive to think about Amazon and somehow, if we fixed Amazon, we would fix the world, but the reality is that most problems get fixed in our backyard. And the more that those problems get fixed in our backyard, the more there's kind of knock-on effect.

Larry Bernstein:

Ben, one of my favorite chapters in your book relates to finding shelf space for a new product. I don't remember the details, but there was some sort of a Slaw product that this woman had purchased the rights for and was trying to get it on shelves and enormous challenges for entrepreneurs, innovators, to actually get space in the modern supermarket. Maybe you could comment on that and talk about that in the context of creative disruption and innovation in that grocery store.

Benjamin Lorr:

So that was Slawsa, a combination of coleslaw and salsa.

Larry Bernstein:

Fantastic.

Benjamin Lorr:

Kind of a lost dog of a product. It tastes delicious. I promised I wouldn't feature anything that I wouldn't eat, myself, but partly because of these very low margins in the industry, supermarkets are such a volume game, they've invented ways of getting their margins in other places besides price on shelf. And that comes through selling shelf space, which is not that ... It sounds odd because I think, when you walk into a supermarket, you picture something like a public market, where the best possible items are going to be there because they've survived some competitive forces to get on shelf, but actually what you're viewing is a curated assortment of things that the category manager or grocery buyer has put there and they're all leveraged off of each other to either highlight items with really high gross margins for them or they've just paid to play and are there because the entrepreneur or producer has put up some money to get on shelf.

And that money, called trade spend, comes in a variety of different ways from outright slotting fees where they're literally just paying money for inches on shelf space. And these are not small numbers either. You're talking about a million dollars for nationwide rollout of a single SKU and that's one item in the frozen aisle, \$50,000 for a 12-inch section in an upscale supermarket, to payments for internal promotion fees or buy-one-get-ones or all these free tastings where the supermarket is essentially getting free cases of product in exchange for some dubious promotion. And so there's this whole kind of ... It's just a different business.

Larry Bernstein:

Actually, think about this, Ben, because you mentioned earlier that the supermarket basically doesn't make any money. It's just unbelievable. It makes two cents for every dollar of revenue. So the place is lean, right? And so what are they selling? The business is selling shelf space and these firms have become very entrepreneurial on how to sell that shelf space. It's there for the highest bidder. They have all these gimmicks. You can buy one get one free. You can have the tastings, as you described. In many ways, it's like your modern department store, except it's food.

Benjamin Lorr:

That's right. I mean, like other places that take a percentage for using their platform.

Larry Bernstein:

That's all they're selling, is their platform. That's all they got. They got this box and they're trying to get as much out of that box as they can, but it's so competitive, going back to what Philippe was talking about. We want a highly-competitive environment. The American grocery

store has to be the most competitive place known to man. They're making 2%. I actually think Amazon is only making 1.5% on their sales. It's unbelievable how competitive these markets are. Everyone's got to be the best in logistics and best in marketing, et cetera. How should we think about this grocery store from 10,000 feet up? Is it the most dynamic, fantastic store that is offering this enormous breadth? Let me ask, maybe, ask you this question; when you think about the future, if 25 or 50 years from now, your children or grandchildren go to his grocery store, what would it look like and how will they view that experience?

Benjamin Lorr:

Well, let me give a slightly disappointing answer, but I think it's real, is that nobody really knows how they're ... People are thinking about this inside the industry in a very confused manner because both of those things coexist with each other. On one point, they're taking very slim, very razor-thin margins off products. On the other hand, they're running this backdoor platform fee where they have all these different not straightforward charges that they're taking. And if someone is making money in their business, they're going to come after it, but again, it's not just through slotting fees, which is inches for dollars. It's through a whole wide range of backdoor things that will change, year to year, just so they get their cut.

I talked to some consultant when writing a book and he was like, "Nobody knows what anything costs in this industry." Their internal bottom lines are often very fuzzy for them because they're getting their margins. These two things are coexisting at the same time, which allows people to say, on one hand, "Oh, we're so lean and efficient. Look at this," and on the other hand, very backwards.

I think that, to go back to your question, where this will go in the future is I do think there'll be a great movement away from a lot of these tacky tacky things. There'll be a movement towards consistency. I think computers help us make sense of big numbers and big volumes and help from artificial intelligence in applying things to these problems is going to do away with a lot of the antiquated parts of the grocery industry, but right now, it's a big cluster, big mess.