Three Part Series: Fundamental Forces Affecting Growers and Marketers

Part 3: The Lettuce/Leafy Greens Sector

By Roberta L. Cook

New entrants and product substitution are intensifying competition in the lettuce/leafy greens sector, whether in the commodity or fresh-cut side of the business. For years the industry witnessed commodity lettuce shippers entering the fresh-cut sector, but more recently, slowing demand in the fresh-cut lettuce category and intense competition from private label processors has reversed the trend. Not only is there more competition across product form (fresh-cut vs. bulk), but also between types of lettuce, and in some cases, across geographic regions.

The vast majority of iceberg, romaine, and leaf lettuce is grown in California. Production is concentrated in the Salinas Valley from April to September, during the winter in the Arizona-California desert, and to a lesser extent Florida. Production takes place in the Huron area of the California central valley in October and March/April as shippers transition from the desert back to Salinas. The south coastal region of California plays a lesser but year-round role.

Although the grower base changes seasonally along with the location of production, the same shippers market the product. Similarly, romaine and leaf lettuce shippers in California and Arizona are substantially the same as for iceberg lettuce, although market shares vary across shippers by lettuce type. The commodity iceberg lettuce industry is quite concentrated with the top four and top eight California shippers controlling an estimated 50 percent and 70 percent, respectively, of the California and Arizona lettuce volume.

Key Elements

The last several years have seen changes in the bulk and fresh-cut lettuce industry, including:

- California firms playing a greater role in importing lettuce from Mexico
- product forms and mixes falling victim to substitution effects
- bulk producers and fresh-cut processors competing in each other's markets.

To learn more about each key element, look for the symbols throughout the article.

ICEBERG

In the iceberg lettuce industry, land requirements for growing high-quality product are quite specific, with the outstanding soil conditions of the Blanco region of the Salinas Valley most coveted and tightly controlled by the same group of longstanding competitors. New entrants to the market from elsewhere in North America have not been a major threat. While increasing, imports represented only 5 percent of U.S. iceberg lettuce utilization in 2011, with 89 percent originating in Mexico and the remainder from Canada.

A surge in summer iceberg imports from Eastern Canada into the U.S. northeastern market in 2010 concerned some California growers but was not sustained in 2011. Nevertheless, California shippers continue to feel growing summer competition from Eastern Canadian lettuce producers in their own market as this region of Canada becomes less import dependent (for romaine and leaf as well).

The real story is not increasing competition from Canada, but rather a reversal of the relative importance of Mexico and Canada over the last decade as suppliers of romaine and leaf lettuce to the U.S. market.

Mexican iceberg lettuce is grown primarily in the country's central, temperate high plain where some U.S. firms operate export operations as part of a geographic diversification strategy. In addition to spreading weather-related risks, shipping costs to East Coast markets are lower from this location than from California. However, rain during the summer season can negatively affect product quality.

While the expanding buy-local trend has brought new entrants from other states into the leafy green subsector as a whole, it has not been the case for iceberg lettuce. In addition to technical production constraints (i.e., time necessary to reach good head size and the negative impact of rain on quality), declining consumer demand (discussed below) has likely dissuaded new entrants to the iceberg lettuce industry.

ROMAINE AND LEAF LETTUCE

Bulk romaine and leaf lettuce consumption appears to be experiencing more growth in competition from "local" growers in other parts of the country due to less stringent growing conditions than for iceberg and romaine hearts, and increasing demand. However, no public data is available on production in states with small volume, so the impact cannot be directly measured. We do know that limited shipping seasons (due to climate constraints) in the rest of the country concentrate most of the impact on California growers in the July to September period. The emerging competition appears to be significant enough for some California shippers to reduce their plantings for harvest during this window.

Romaine and leaf consumption is mainly supplied domestically; despite a seven-fold rise in U.S. imports over the last decade, in 2011 imports still represented only 3 percent of U.S. utilization. Despite their small share currently, a closer look at imports sheds light on some important emerging patterns. Although California shippers recently reported growing competition from Eastern Canada in the summer/fall, analysis of import data from the Department of Commerce showed that imports of leaf and romaine from Canada actually peaked in 2009 at 34 million pounds. Thereafter imports declined to 22.9 million pounds in 2011, similar to the import levels observed at the beginning of the decade.

The real story is not increasing competition from Canada, but rather a reversal of the relative importance of Mexico and Canada over the last decade as suppliers of romaine and leaf lettuce to the U.S. market. Whereas in 2000 Mexico accounted for 25 percent of U.S. imports and Canada 73 percent, Mexico is now the principal foreign supplier, contributing 79 percent of 2011 imports, with Canada's share shrinking to 20 percent. Mexico's exports of leaf and romaine to the United States have grown in all months of the year. While winter is still Mexico's dominant export season, it has essentially become a year-round supplier due to both winter and summer growing regions suitable for these crops.

California firms play a key role in the small but expanding lettuce import market from Mexico. For all lettuce types, most imports enter the country as part of the sourcing and marketing programs of California grower-shippers. This means the lettuce subsector avoids fragmentation at the handler and importer levels, compared with many produce items which rely heavily on imports and make extensive use of brokers and distributors based in key import locations.

It also means that the future of lettuce imports depends in large part on California grower-shippers and their ongoing interest in investing in alternative production operations in Mexico. While California and Arizona are by far the preferred locations, some lettuce growers may be developing production in Mexico partly as a hedge against future labor and regulatory restrictions in the United States.

MARKET SUBSTITUTES

Changes in product form and mix have not caused major growth in overall lettuce consumption. Like many fresh produce items, leafy greens are subject to substitutes within product categories. Per capita consumption of iceberg, leaf, and romaine lettuce combined grew only slightly between 1985 and 2011, from 27.0 to 26.2 pounds per capita.

This stagnation masks dramatic changes within the lettuce category as a whole. Romaine and other leaf lettuces have cannibalized sales from iceberg lettuce. Per capita consumption of romaine and leaf lettuces grew from 3.3 pounds in 1985 to 10.7 in 2011, while iceberg lettuce declined from 23.7 to 15.5 pounds per capita over the same period. Per capita consumption figures include both fresh-cut ready-to-eat (RTE) and commodity/bulk forms sold through retail and foodservice marketing channels. Hence, the proliferation in more convenient fresh-cut lettuce options (discussed below) and robust product introductions for retail and foodservice markets did not stimulate major gains in lettuce consumption.

Over the years, the original California iceberg commodity shippers simply changed their product mixes in response to evolving consumer preferences, while retaining marketing control of the subsector. Though rankings may have changed, the top players are the same as they were many years ago, and with the exception of Dole, most are multigeneration family-owned businesses.

COMPETITION: NEW ENTRANTS

In the last twenty years, major new entrants to the lettuce/leafy greens subsector came not in the bulk lettuce commodity market, nor from foreign competitors, but in the form of fresh-cut processors offering consumers a convenient RTE substitute for bulk lettuce. Two commodity lettuce shippers developed the bagged salad industry, a family-owned grower-shipper that founded Fresh Express, and Dole.

The development of the fresh-cut industry was a game changer and existing commodity lettuce shippers faced a critical strategic decision, whether or not to enter the fresh-cut industry. Barriers to entry were and remain significant, not just from the capital investment, production, and technology standpoints, but from marketing challenges as well. Furthermore, many shippers have found it difficult to compete successfully in both commodity and fresh-cut markets simultaneously.

FRESH-CUT & BAGGED SALADS

The lettuce business comes full circle as fresh-cut firms reenter the commodity lettuce business. Once having entered the fresh-cut category exit barriers are sufficient to keep marginal players in place longer than market conditions might warrant. The bagged salad business is maturing with total quantity sold relatively flat in recent years. Firms have found that adding value does not necessarily equate to greater profitability, a lesson learned, incidentally, in many fresh produce crops.

Based on retail scanner data for 2010/2011, the top two and top four branded bagged salad firms are estimated to account for 58 percent and 68 percent, respectively, of bagged salad sales in conventional supermarkets. The top four market share was even higher for many years until private label products grew as a substitute for branded bagged salads.

Commodity shippers entering the fresh-cut category after its initial emergence were compelled to focus on not only private label sales to retailers but the foodservice market as well. Both are very price-oriented buyers, but do not require large investments in consumer packaged goods branded marketing programs.

The recent rapid growth in retailer demand for private labels—resulting from the economic downturn—is very much in evidence in this sector. Today, private label sales now comprise around one-quarter of bagged salad sales in supermarket channels, even eclipsing the market share of the second largest branded player, Dole, in 2011. Retail bagged salad market leader Fresh Express reported a seven percent decline in 2011 sales to $953 million due to competition from private labels. As part of its strategic response, in 2011 Fresh Express reentered the commodity lettuce business (iceberg and romaine heart) after its exit two decades ago.

In recent years a new competitor emerged with the entrance of the largest U.S. fresh-cut processor, Taylor Fresh Foods, formerly focusing on the foodservice market—a major but maturing market for fresh-cut lettuce—into the retail bagged salad category. Even with its position as the largest U.S. fresh-cut processor, as a latecomer to retail bagged salads, Taylor has increasingly pursued a private label strategy. Hence, competition today is greater than ever for both branded and private label bagged salad players, presumably discouraging further new entrants and encouraging further consolidation. Like Fresh Express, Taylor Farms now has a small position in the commodity lettuce market after its 2010 acquisition of River Ranch, operated as a wholly-owned subsidiary. Taylor Farms also operates a fresh-cut processing plant in central Mexico and is a contributor to the growth in U.S. lettuce imports from Mexico.

CLOSING COMMENTS

Although the U.S. lettuce industry, taken as a whole, is relatively mature, there have been major internal shifts in product form, mix, and the relative roles of industry players. The still dominant but declining iceberg lettuce industry has experienced fewer threats from new entrants than leaf lettuce due in part to very specific growing conditions and requirements. The development of the convenience-oriented fresh-cut industry has contributed to what little growth there has been in lettuce consumption, but even more importantly, has likely forestalled a decline in consumption that may have occurred in its absence given a proliferation in the availability of competing fruits and vegetables over the last twenty years.

On the other hand, active new product development in the fresh-cut industry means more substitutes for bulk products sold in the commodity market. Without an expanding pie, price competition has grown in both segments, intensified by the growth of private labels in the fresh-cut lettuce category. The future outlook depends in part on the economy, as economic growth will contribute to higher demand in both retail and foodservice channels. In the meantime, price and margin pressure will force firms to focus on efficiency gains, while marginal players will likely be absorbed. BP

Roberta Cook is Cooperative Extension Specialist, Department of Agricultural and Resource Economics at the University of California, Davis.

PBH Donors . . . Sowing the seeds for a healthier America, while reaping the benefits of being a PBH supporter!

Produce for Better Health Foundation is a recognized leader in consumer marketing and research related to fruits and vegetables.

Contact us today about how we can help you reach primary shoppers and how you can automatically receive the value-added benefits of being a PBH supporter!

FRESH | FROZEN | CANNED | DRIED | 100% JUICE
IT ALL MATTERS!

fruits & veggies more matters®

Contact Renee Bullion at **rbullion@PBHFoundation.org**, or Cyndy Dennis at **cdennis@PBHFoundation.org.**