Analysis of the Traditional Grocery Store Industry

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Abstract
In recent years, the traditional grocery store industry has found itself losing ground to a number of competing industries. Supercenters like Wal-Mart and pharmacies like CVS are selling groceries as a secondary business, thus adding external pressures on the traditional supermarkets. This paper examines how the field of internal and external competitors became so crowded, while also taking an in-depth look at where the grocery store industry is today and where it is headed in the future.
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Introduction
While consumer trends continue to fluctuate and Americans are forced to adapt to an ever-changing marketplace, one thing will never change: People need their groceries. A 2012 Gallup survey found that Americans report spending an average of $151 on food per week, with 10% of Americans saying they spend $300 or more.¹ See Exhibit A below.

Exhibit A²

<table>
<thead>
<tr>
<th>On the average, about how much does your family spend on food each week?</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $50</td>
<td>8</td>
</tr>
<tr>
<td>$50 to $99</td>
<td>17</td>
</tr>
<tr>
<td>$100 to $124</td>
<td>22</td>
</tr>
<tr>
<td>$125 to $149</td>
<td>4</td>
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<tr>
<td>$150 to $199</td>
<td>15</td>
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<td>$300 or more</td>
<td>10</td>
</tr>
<tr>
<td>No opinion</td>
<td>4</td>
</tr>
<tr>
<td>Mean</td>
<td>$151</td>
</tr>
<tr>
<td>Median</td>
<td>$125</td>
</tr>
</tbody>
</table>

July 9-12, 2012
GALLUP

But what has changed is where these groceries are coming from. No longer is the traditional supermarket – think a Giant or a Safeway or a Kroger – the only outlet for a family to find a week’s worth of meals. Consumers are turning more and more towards less conventional places for their food. Pharmacies, big-box discounters, warehouse clubs and even the Internet provide consumers with alternative sources for their groceries, pushing the traditional grocery stores into a corner.

¹ Elizabeth Mendes. “Americans Spend $151 a Week on Food; the High-Income, $180,” Gallup (August 12, 2012)
² Ibid
Background

In 2011, traditional supermarkets found their share of U.S. grocery sales at a mere 51%, down from 66% in 2000.³ Research from analysts at UBS attributes this decline to a change in strategy amongst big-box discounters like Target and Wal-Mart.⁴ A discounter can keep food prices extremely low as a strategy to lure a customer into the store, where he’ll then be more likely to buy something more profitable, like housewares or clothing.⁵ A traditional grocery store does not have this luxury. Maybe they can provide a larger variety of food offerings than a discounter, but the prices will always be higher than someone would see at his local Wal-Mart. Supervalu Chief Executive Craig Herkert backs up this claim, saying, "In this economy, it's simply not acceptable anymore to have prices as far out of line as ours have been. But getting prices 'right' for us doesn't mean we are going to become a discounter. It means we have to narrow that pricing gap."⁶

Traditional supermarket chains are now stuck in a difficult place. As more the wealthy shoppers pay premiums on organic produce at a Whole Foods Market Inc, the stingier, budget-conscious consumers are drawn to discount chains or dollar stores like Dollar General Inc.⁷ Families are value-seeking by at warehouse clubs like Costco Wholesale Corp.'s and are now only making trips to traditional supermarkets for specific deals, thus leading to lower sales and thinner profits.⁸

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³ Annie Gasparo and Timothy W. Martin. “What’s Wrong With America’s Supermarkets?,” Wall Street Journal (July 12, 2012)
⁴ Ibid
⁵ Ibid
⁶ Ibid
⁷ Ibid
⁸ Ibid
But large supermarkets don’t want to simply cater to a niche; they want to continue to serve as the single place for everyone to grab their groceries each week. For decades, grocery stores could bring in customers with promotions while earning profits off of high-margin products sold at full-price. But this is a thing of the past. UBS analyst Jason DeRise said, "Supermarkets cannot continue to do the same things they did in 1990s and expect a different result than the one seen over the last 10 years."\(^9\)

Stubbornness will lead nowhere but to a further decrease in market share. Just last year, Supervalu sold $37.5 billion of merchandise, but found itself with margins of just 4.9%, leading to a $1.1 billion loss. This trend will continue unless the industry finds a way to attract and keep customers who are there for more than just one sale. It is imperative that the industry learns how to adapt with the environment and find a way to continue adding value to its customers if it wants to succeed into the future.

**External Analysis**

*Drivers*

**Per Capita Disposable Income\(^10\)**

Unsurprisingly, the amount of disposable income consumers have helps drive grocery store sales. With low amounts of disposable income, consumers will stick to necessities – milk, bread and other staples – while avoiding luxury items and other superfluous food choices. A family with little to spend is going to spend what they have on only the necessary goods. They will also be far more willing to substitute name-brand goods for the cheaper, generic brands. Unsurprisingly, these decreases in consumer

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\(^9\) Annie Gasparo and Timothy W. Martin. “What’s Wrong With America’s Supermarkets?,” *Wall Street Journal* (July 12, 2012)

\(^10\) Jeffrey Cohen. “Supermarkets and Grocery Stores in the US,” *IBISWorld* (January 2014)
spending have a negative impact on grocery store sales. The direct impact is lower revenues: if people are spending less at grocery stores, the stores are making less money. But one potentially unforeseen effect is the use of substitute stores and industries. Wal-Mart, already the number one seller of food nationwide, becomes a far more attractive alternative to a grocery store when disposable income is limited. Wal-Mart is able to price itself far lower than a traditional grocery store can, as it can sacrifice its food margins knowing that customers will also make higher margin purchases during their trips to the store. As a result, Kroger is priced about 8% to 10% higher than Wal-Mart, while Supervalu and Safeway stores were priced around 18% to 20% higher.\(^{11}\) Kroger chief financial officer Mike Schlotman said, "Traditional supermarkets have gotten too high in price, and when you get to that point, price does start to trump convenience."\(^ {12}\)

Still, there is reason for optimism in the future. IBISWorld reports that per capita disposable income is expected to increase in 2014, "representing a potential opportunity for the industry."\(^ {13}\) With more money in the pockets of consumers, the convenience of Wal-Mart becomes less of a priority. Consumers will return to the familiar, standard feel of a traditional grocery store, hopefully allowing these stores to regain some market share. Additionally, consumers will make larger purchases, thus increasing revenues across the industry. See Exhibit B below.

\(^{11}\) Annie Gasparo and Timothy W. Martin. "What’s Wrong With America’s Supermarkets?," *Wall Street Journal* (July 12, 2012)

\(^{12}\) Ibid

\(^{13}\) Jeffrey Cohen. “Supermarkets and Grocery Stores in the US,” *IBISWorld* (January 2014)
Consumer Confidence Index

As seen in Exhibit B above, America is just now escaping from a sharp decline in consumer confidence, during which consumers typically shop more at supermarkets for food purchases rather than eat at restaurants, but make significantly smaller purchases than they do during periods when consumer sentiment is high. The consumer confidence index, which takes into account the current status of household wealth, business conditions, unemployment, inflation, disposable income and government economic policy, can highlight future spending patterns. As seen in Exhibit B, the consumer sentiment index is expected to increase in 2014, potentially increasing the quantity of goods bought at grocery stores. While this may also cause consumers to look towards restaurants more frequently, the counterbalance with larger shopping trips should be beneficial to the industry as a whole.

Population

Grocery stores’ locations and successes are often largely determined by the population of a particular city, county or state. Additionally, industry leaders will pay

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14 Jeffrey Cohen. “Supermarkets and Grocery Stores in the US,” IBISWorld (January 2014)
15 Ibid
16 Ibid
close attention to the age distribution of a population, as that will allow them to better tailor their stores to their customers’ needs. For example, IBISWorld reports that teenagers typically demand more snack foods and prepared meals than older consumers.\(^{17}\)

The US population is expected to increase slowly in 2014. This will have an impact on the grocery store industry as revenues should increase as a result of a larger customer base, but this impact may be negligible. Other factors, like the aforementioned consumer confidence index or the levels of disposable income, will determine whether or not consumers turn to traditional supermarkets for their groceries.

**Competitors**

A survey from retail design firm King Retail Solutions of over 1200 shoppers revealed that 77% percent of respondents bought groceries from a non-grocer in 2013. Additionally, 96% of those surveyed claimed that they intend to buy groceries from places other than grocery stores in 2014, a staggeringly high statistic that speaks volumes about where the grocery store industry may be heading.\(^{18}\)

**Warehouse Clubs and Supercenters**

Big-box store and supercenters have long been involved in the groceries game, but they have been making significant progress in recent years. Grocery sales have increased in importance to Wal-Mart and Target as sales of once-profitable traffic drivers like CDs and DVDS have decreased to the point of near irrelevance. In 2012, groceries accounted for 55% of Wal-Mart's $264.2 billion in U.S. sales, up from 41% just four

\(^{17}\) Jeffrey Cohen. “Supermarkets and Grocery Stores in the US,” *IBISWorld* (January 2014)

years ago, while also investing $1 billion to lower food prices.\textsuperscript{19} Euromonitor International puts Wal-Mart’s market share in the grocery industry at a whopping 30%, making it the US leader, far ahead of any of the traditional grocery stores.\textsuperscript{20}

Target sells a full assortment of groceries only in its 450 Super Target stores, but its new fresh and expanded frozen food sections are now in 75% of the chain. Food accounted for 19% of Target's $68 billion in sales in 2011, a slight increase from 16% in 2009.\textsuperscript{21}\textsuperscript{22}

Both Wal-Mart and Target are able to offer lower prices than grocery stores, as their higher-margin offerings allow them to make money elsewhere. While a grocery store needs the margins from groceries, Wal-Mart can sell a customer cheap bread and milk while getting them to buy the higher margin clothing at the same time. This luxury forces grocery stores to gain a competitive advantage elsewhere, as Wal-Mart will always win the cost battle.

Costco customers pay an annual fee for access to low prices on consumables like fresh foods, health and beauty care items, high-quality apparel, electronics, hardware, jewelry and other general merchandise. Its membership format promotes customer loyalty and creates a recurring revenue stream, which in turn allows the company to lower its retail prices. In 2014, Costco is expected to generate $113.4 billion in total revenue. The company has been constantly increasing its product range since 2009, and

\footnotesize{\textsuperscript{19} Annie Gasparo and Timothy W. Martin. “What’s Wrong With America’s Supermarkets?,” Wall Street Journal (July 12, 2012)}
\footnotesize{\textsuperscript{20} Jeffrey Cohen. “Supermarkets and Grocery Stores in the US,” IBISWorld (January 2014)}
\footnotesize{\textsuperscript{21} Annie Gasparo and Timothy W. Martin. “What’s Wrong With America’s Supermarkets?,” Wall Street Journal (July 12, 2012)}
\footnotesize{\textsuperscript{22} Stephanie Clifford. “Groceries Fill Aisles At Stores Like CVS,” The New York Times (January 16, 2011)}
has expanded its premium private-label Kirkland Signature to about 300 items, thus further differentiating the brand.\textsuperscript{23}

**Pharmacies**

The aforementioned King Retail Solutions survey revealed Target and Wal-Mart as the top two non-traditional grocers in America. But just behind them were pharmacy giants Walgreens and CVS.\textsuperscript{24} Walgreens began making over some stores in Chicago and New York a year ago, and added up to 500 food items. CVS redesigned about 200 of its stores in urban areas like Boston, Detroit and New York last year, and expects to make over about 20 percent of its 7,100 stores in all.\textsuperscript{25}

While CVS may never become the store of choice for all of a customer’s grocery needs, it often provides convenience as well as a passable offering of food products for one to purchase. King Retail Solutions’s Andrew Swedenborg said, “It can’t all be about one-stop-shop, but if it’s a retailer they appreciate, they are going to shop there.”\textsuperscript{26} Maybe CVS isn’t the perfect outlet, but consumers respect it and they offer all of the staple goods for respectable prices, making it a reasonable option, one-stop-shop or not.

**Convenience Stores**

Since 2009, the Convenience Stores industry has maintained profitability by offering convenience, value and by increasing its selection of fresh and healthy products. Due to their small size, convenience stores are able to quickly adapt to changes in the shopping environment and consumer preferences, making them more resilient than

\textsuperscript{23} Sally Lerman. “Warehouse Clubs & Supercenters in the US,” \textit{IBISWorld} (March 2014)

\textsuperscript{24} Clare O’Connor. “Are Grocery Stores Doomed? Study Shows More Shoppers Buying Food At Target, Walmart, Pharmacies,” \textit{Forbes} (February 18, 2014)

\textsuperscript{25} Stephanie Clifford. “Groceries Fill Aisles At Stores Like CVS,” \textit{The New York Times} (January 16, 2011)

\textsuperscript{26} Clare O’Connor. “Are Grocery Stores Doomed? Study Shows More Shoppers Buying Food At Target, Walmart, Pharmacies,” \textit{Forbes} (February 18, 2014)
supermarkets to the recession. As a result of this, the product mix has drastically shifted to include food service products that are more profitable than items such as cigarettes and focused on satisfying demand for quick meal options. A steadily increasing amount of American consumers now perceive themselves as “time pressed” as more they return to work and school in the years following the recession, thus making speed a huge factor to many people. IBISWorld anticipates this demand for speed to lead to industry revenue growth of 1.7% annually to $41.9 billion in the five years to 2014, which includes an increase of 1.8% in 2014 alone.27

Internet Alternatives

While consumers may be willing to make many of their purchases online, the idea of making an online grocery purchase with someone other than Peapod or Safeway is still foreign to most. Still, this isn’t stopping companies like Amazon from creeping into the grocery landscape, posing a potential threat to the industry. The company has introduced a new device in select markets where its Amazon Fresh delivery service is available that allows customers to shop for groceries without leaving their home in the simplest way possible. The Amazon Dash is a small handheld wand that lets users scan product bar codes or just name an item to have it added to a shopping list. Once a list is built customers simply log in to their Amazon account to schedule their delivery.28 Of course, the product may not be as perfect as it sounds and Fresh is already so limited that it may be years away from becoming a threat, but it is certainly intriguing.

The potential of Dash sums up much of the Internet grocery world: intriguing but not quite there. According to research at the University of Wisconsin, forecasts during the

28 Daniel Kline. “Can Amazon Dash Make Amazon Fresh a True Grocery Store Competitor?,” The Motley Fool (April 7, 2014)
late 1990s saw online grocery stores as an $11 billion business.\textsuperscript{29} These estimates were clearly incorrect. Today, the Internet looms as a future threat – or an ally if its harnessed by a traditional store – but nothing more. Individual items may be poached from grocery stores – buying shampoo in bulk for cheap off of Amazon is pretty appealing – but the fear of ordering fresh food online is still too much for too many people.\textsuperscript{30} Still, the Internet must be closely monitored, as it will undoubtedly be a necessity in the future. See Exhibit C below.

Exhibit C\textsuperscript{31}

Dollar Stores

The Dollar and Variety Stores industry is one of the fastest-growing industries in the retail sector, in large part due to caution in the wake of the recession. IBISWorld

\textsuperscript{29} Chad Navis. “Failure to Deliver: Why Did Online Grocery Stores Crumble?,” Wisconsin MBA (May 4, 2012)

\textsuperscript{30} Ibid

\textsuperscript{31} Nicholas Hodson, Thom Blischok and Matthew Egol. “Four Forces Shaping Competition in Grocery Retailing,” Booz & Company (2012)
estimates that revenues will increase at an average annual rate of 4.8% to $59.8 billion in the five years to 2013. The industry offers a wide range of merchandise, which it buys and sells for low prices. During the recession, people began to seek value, as both consumer sentiment and disposable income rapidly fell. Consequently, the industry has attracted new value-focused, middle-income consumers who have not traditionally shopped at dollar stores. From 2012 to 2013, revenue is expected to grow 3.8%.\textsuperscript{32}

Even as consumer sentiment and confidence begin to rise, many experts believe that a sizable segment of the population will continue seeking value wherever they can get it. The newly taught spending habits bode well for the dollar store industry, as the newly found middle-class segment may continue to ignore traditional grocery stores.\textsuperscript{33}

**Internal Analysis**

Per IBISWorld, the Supermarkets and Grocery Stores industry retails food products, including fresh and prepared meals, poultry and seafood, canned and frozen foods, fresh fruit and vegetables and various dairy products.\textsuperscript{34} The industry is in the mature phase of its life cycle and is expected to grow at a slower rate than the overall economy during the 10 years to 2019.\textsuperscript{35}

Since 2009, fluctuations in household disposable income have led consumers to reduce the quality and quantity of goods they purchased at grocery stores, thus decreasing

\begin{thebibliography}{9}
\bibitem{32} Natalie Everett. “Dollar & Variety Stores in the US,” *IBISWorld* (September 2013)
\bibitem{33} Nicholas Hodson, Thom Blischok and Matthew Egol. “Four Forces Shaping Competition in Grocery Retailing,” *Booz & Company* (2012)
\bibitem{34} Jeffrey Cohen. “Supermarkets and Grocery Stores in the US,” *IBISWorld* (January 2014)
\bibitem{35} Ibid
\end{thebibliography}
revenues for the industry. Overall, industry revenue fell at an annualized rate of 0.4% to $522.5 billion, including a 1.7% decrease in 2014.\textsuperscript{36} See Exhibit D below.

Exhibit D\textsuperscript{37}

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue $ million</th>
<th>Growth %</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>509,519.5</td>
<td>0.0</td>
</tr>
<tr>
<td>2001</td>
<td>517,676.1</td>
<td>1.6</td>
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<tr>
<td>2002</td>
<td>506,858.0</td>
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<tr>
<td>2004</td>
<td>514,223.0</td>
<td>0.4</td>
</tr>
<tr>
<td>2005</td>
<td>517,893.7</td>
<td>0.7</td>
</tr>
<tr>
<td>2006</td>
<td>517,794.4</td>
<td>0.0</td>
</tr>
<tr>
<td>2007</td>
<td>524,204.7</td>
<td>1.2</td>
</tr>
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<td>2008</td>
<td>537,793.6</td>
<td>2.6</td>
</tr>
<tr>
<td>2009</td>
<td>532,906.0</td>
<td>-0.9</td>
</tr>
<tr>
<td>2010</td>
<td>532,305.4</td>
<td>0.5</td>
</tr>
<tr>
<td>2011</td>
<td>531,230.5</td>
<td>-0.8</td>
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<tr>
<td>2012</td>
<td>529,433.4</td>
<td>-0.3</td>
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<tr>
<td>2013</td>
<td>531,395.2</td>
<td>0.4</td>
</tr>
<tr>
<td>2014</td>
<td>522,454.7</td>
<td>-1.7</td>
</tr>
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</table>

In recent years, the industry has struggled to maintain its paper-thin profit margins due to rising costs and market saturation. National, regional, local and independent supermarkets compete against one another, while also going head-to-head with supercenters, warehouse clubs, the Internet, dollar stores, convenience stores, and pharmacies, among others. This oversaturation has led to decreases in prices to stay competitive, which has eaten into profit margins even further. In more extreme cases, there has been downsizing, Chapter 11 bankruptcy protection, and mergers and acquisitions. In fact, the number of enterprises has decreased at an annualized rate of 1.1% over the past five years to 35,761. As a result, the number of employees is

\textsuperscript{36} Jeffrey Cohen. “Supermarkets and Grocery Stores in the US,” \textit{IBISWorld} (January 2014)

\textsuperscript{37} Ibid
anticipated to decrease at an annualized rate of 0.1% to 2,274,948 during the five years to 2014.\(^{38}\)

Due to high internal competition, supermarkets operate on a high inventory turnover rate with slim profit margins, due to low retail markups for products. Profit is expected to contract from 1.5% of revenue in 2009 to a mere 1.3% in 2014. While grocery stores aimed to cut costs by shrinking their employee headcount and wage costs, the continued pressure of low profit margins forced many smaller industry players out of business.\(^{39}\)

Beyond internal and external competition, the high price of food inputs such as grains, fats and oils has limited grocery stores' profitability. According to the World Bank's quarterly Food Price Watch report, food prices have increased by as much as 7% from 2011 to 2012. Grains have increased by 12% and the price of corn increased by about 17%. Food prices have fluctuated over the past five years, but they are expected to increase in 2014, further eroding industry profits.\(^{40}\)

As seen with Costco’s Kirkland brand, in-house or private-label brands have become a prominent factor in driving performance. During the past five years, grocery store in-house brands have outperformed name-brand manufacturers by offering limited shelf space and leasing terms and conditions. Some grocery stores even give their own brands prominent shelf space and in-store displays as a means of boosting sales. But even without this preferential treatment, many consumers simply appreciate and enjoy the in-house brands for their relative good quality and cheap price. According to the Nielsen

\(^{38}\) Jeffrey Cohen. “Supermarkets and Grocery Stores in the US,” IBISWorld (January 2014)

\(^{39}\) Ibid

\(^{40}\) Ibid
Company, most consumers feel that store brands rank as good as, if not better, than national brands. Store-brand goods have seen a 21.0% growth and are estimated to account for about 11.0% of total supermarket sales in 2014.\textsuperscript{41}

The products supplied by the grocery store industry have almost all reached saturation levels. Real growth in the industry comes from the introduction of new niche market goods or advances in product formulas. Unsurprisingly, the market for grocery products has undergone little change in recent years.\textsuperscript{42}

\textit{Customer Base}\textsuperscript{43}

Grocery store revenues are split relatively evenly between different income levels. Households earning less than $5,000 to $19,999 annually account for 32.4% of revenue in 2014. These consumers buy generic brands and staple products like milk, meat and bread. This segment is heavily swayed by price and convenience, thus making them prime candidates to drift towards supercenters and warehouse clubs like Costco and Wal-Mart. One-stop shopping coupled with lower prices makes these stores far more suitable to the needs of lower income families looking to make few trips for cheap food and other items.\textsuperscript{44}

The more middle class segment featuring earnings between $20,000 and $49,999 accounts for 33.3% of revenue in 2014. These buy both generic-brand and premium-brand items, making them candidates to shop at any and all types of stores. This particular segment also has a tendency to take advantage of the pharmacies within

\textsuperscript{41} Jeffrey Cohen. “Supermarkets and Grocery Stores in the US,” \textit{IBISWorld} (January 2014)
\textsuperscript{42} Ibid
\textsuperscript{43} Ibid
\textsuperscript{44} Ibid
grocery stores, where this segment tends to buy personal care products and drugs, per IBISWorld.\textsuperscript{45}

Finally, higher-class households earning over $50,000 account for 34.3% of revenue in 2014. This segment is more likely to purchase premium-brand items. This segment also purchases a larger amount of discretionary items such as personal care products and drugs from in-store pharmacies compared to consumers in the lower income segments.\textsuperscript{46}

Research from the Progressive Grocer, a food retail industry publication, shows that female heads of household account for about 70% of supermarket and grocery shopping, with male heads of households accounting for around 20% of the shopping. The final 10% is made up of even splits between men and women shopping equally or from personal housekeepers and chefs who do the shopping on behalf of the household.\textsuperscript{47}

\textit{Key Players}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{key_players.pdf}
\caption{Key Players}
\end{figure}

\textsuperscript{45} Jeffrey Cohen. “Supermarkets and Grocery Stores in the US,” \textit{IBISWorld} (January 2014)
\textsuperscript{46} Ibid
\textsuperscript{47} Ibid
\textsuperscript{48} Ibid
Kroger

The Kroger Company, founded in 1883 in Cincinnati, Ohio, is the largest grocery store chain in the United States. Kroger currently employs more than 339,000 people and is expected to generate total revenues of about $102.3 billion in 2014.49

The company operates in four segments: food and drug stores, multidepartment stores, jewelry stores and convenience stores, including more than 2,400 supermarkets and grocery stores across the United States. These stores accounted for more than 93.1% of total company revenue in 2012. Presently, Kroger trades under 16 brand names across 32 states. The company features extensive use of private labels as a means to differentiate its products and compete against other industry players. These 14,000 private-label items are split into three separate tiers: the premium quality Private Selection, the popular mid-range Banner brand, and Kroger Value, which is the price-focused offering.50

As the industry leader, Kroger attempts to make large acquisitions in locations where it can expand its market share. In 2011, for example, the company acquired eight stores from Schnucks, a St. Louis-based grocery chain, in Memphis, Tennessee. In 2013, Kroger acquired North Carolina-based grocery store, Harris Teeter, the 33rd top food retailer and wholesaler in the United States, thus positioning Kroger to succeed and gain market share in the Southeast.51

As a result of strong overall growth throughout the five years to 2014, the company's revenue is expected to increase at an annualized rate of 4.7% to $84.0 billion. In fact, it reported its same-store sales, a key indicator of retailer health, rose 4.2% for the

49 Jeffrey Cohen. “Supermarkets and Grocery Stores in the US,” IBISWorld (January 2014)
50 Ibid
51 Ibid
quarter ended May 19. Much of this success is built from insights gleaned from a well-designed shopper loyalty card program that has allowed the chain move away from a one-size-fits-all approach to retail, said Jim Hertel, a supermarket consultant with Willard Bishop LLC, based in Barrington, Illinois.\textsuperscript{52} See Exhibit F below.

Exhibit F\textsuperscript{53}

<table>
<thead>
<tr>
<th>Year*</th>
<th>Revenue ($ million)</th>
<th>(% change)</th>
<th>Operating Income ($ million)</th>
<th>(% change)</th>
</tr>
</thead>
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<tr>
<td>2008-09</td>
<td>66,749.0</td>
<td>1.4</td>
<td>951.4</td>
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<td>2009-10</td>
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<td>3.5</td>
<td>1,837.2</td>
<td>93.1</td>
</tr>
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<td>5.0</td>
<td>1,018.6</td>
<td>-45.6</td>
</tr>
<tr>
<td>2011-12</td>
<td>81,074.0</td>
<td>11.8</td>
<td>2,186.3</td>
<td>116.6</td>
</tr>
<tr>
<td>2012-13</td>
<td>82,835.0</td>
<td>2.2</td>
<td>2,465.5</td>
<td>12.8</td>
</tr>
<tr>
<td>2013-14</td>
<td>83,950.2</td>
<td>1.3</td>
<td>2,710.2</td>
<td>9.9</td>
</tr>
</tbody>
</table>

\textsuperscript{*}Year-end January 31

\textsuperscript{**}SOURCE: ANNUAL REPORT

**Safeway**

Safeway Inc. was founded in 1915 and is headquartered in Pleasanton, CA. The company employs more than 171,000 and operates over 1,700 stores, 32 manufacturing plants, and 15 distribution centers. It is expected to generate $46.0 billion in total sales in 2014.\textsuperscript{54}

Safeway has been revamping its stores over the past five years, focusing on a wider variety of perishable food, organic products and high-end groceries, designed to compete with groceries at the more expensive specialist stores. Safeway built or remodeled 164 stores to fit the new format in 2009 and 2010.\textsuperscript{55}

While Safeway is positioned as the second largest traditional grocery store in the United States, the company was hit especially hard by the recession in 2009. The

\textsuperscript{52} Annie Gasparo and Timothy W. Martin. “What’s Wrong With America’s Supermarkets?,” \textit{Wall Street Journal} (July 12, 2012)

\textsuperscript{53} Ibid

\textsuperscript{54} Jeffrey Cohen. “Supermarkets and Grocery Stores in the US,” \textit{IBISWorld} (January 2014)

\textsuperscript{55} Ibid
company saw a 5% decrease in revenues and a $538.2 million loss in operating income. With increased consumer confidence and disposable income, consumers returned to Safeway in 2011 and 2012, bumping revenues by 1.5%. Overall, IBISWorld expects that Safeway will experience an annualized revenue decline of 0.7% to $32.9 billion from 2009 to 2014.\(^56\)

In March 2014, it was announced that Cerberus Capital Management, a private equity company that owns grocery chain Albertson’s, had acquired Safeway for $9.4.\(^57\) After the merger, the combined companies' share of the American grocery market will rise by 42%, putting it nearly on par with industry leader Kroger. Still, combined market share post-merger will be just 5.4%, while Wal-Mart stands at around 30%, according Euromonitor International.\(^58\) See Exhibit G below for Safeway’s recent financial performance.

### Exhibit G\(^59\)

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue ($ million)</th>
<th>% change</th>
<th>Operating Income ($ million)</th>
<th>% change</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>31,687.7</td>
<td>-5.0</td>
<td>-538.2</td>
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<td>31,065.7</td>
<td>-2.0</td>
<td>983.0</td>
<td>N/A</td>
</tr>
<tr>
<td>2011</td>
<td>31,545.1</td>
<td>1.5</td>
<td>959.9</td>
<td>-2.3</td>
</tr>
<tr>
<td>2012</td>
<td>31,636.2</td>
<td>0.3</td>
<td>937.4</td>
<td>-2.3</td>
</tr>
<tr>
<td>2013</td>
<td>32,110.7</td>
<td>1.5</td>
<td>895.4</td>
<td>-4.5</td>
</tr>
<tr>
<td>2014</td>
<td>32,855.1</td>
<td>2.3</td>
<td>910.2</td>
<td>1.7</td>
</tr>
</tbody>
</table>

**Future Landscape**

Industry experts expect slow to moderate growth in the industry in the next five years. See Exhibit H below.

\(^{56}\) Jeffrey Cohen. “Supermarkets and Grocery Stores in the US,” *IBISWorld* (January 2014)

\(^{57}\) Dan Mitchell. “Say Goodbye to Your Supermarket,” *CNNMoney*, (March 14, 2014)

\(^{58}\) Ibid

\(^{59}\) Jeffrey Cohen. “Supermarkets and Grocery Stores in the US,” *IBISWorld* (January 2014)
Rising household disposable income and profit expansion

According to IBISWorld reports, projections point to household disposable income increasing at a faster rate than seen in the previous five years. With this extra spending money, consumers are expected to eat out more often and purchase more premium products at grocery stores, thus increasing the average size of an in-store purchase. As grocery stores continue to offer low prices and discounts to consumers, the total number of purchases will also increase. Experts also point to increasing costs of energy and transportation as a probable cause of potentially increasing food prices. These increasing prices will then make operations that much more expensive, thus increasing competition in the industry. Overall, profit is expected to increase from 1.3% in 2014 to 1.5% in 2019. \(^{61}\)

Competitive strategies on the rise

The traditional grocery store experience used to be viewed as a one-stop shopping trip for the average consumer but data suggests that this is no longer the case, according to research done by the Grocery Manufacturers Association. The research claims that about 75% of today's consumers shop in five or more retail outlets in search of the best price, a trend that experts expect to continue moving forward. Additionally, supercenters

\(^{60}\) Jeffrey Cohen. “Supermarkets and Grocery Stores in the US,” \textit{IBISWorld} (January 2014)

\(^{61}\) Ibid
and warehouse clubs offer consumers a full-blown one-stop-shop experience – one that is not limited just to groceries but to a limitless supply of goods – and are expected to grow as a form of competition to grocery stores in the next five years. Grocery stores are expected to combat this trend with improved customer loyalty programs and rewards cards, which will offer discounts and incentivize return visits while also providing stores with an endless supply of data. This should lead to a more tailored shopping experience, leading to a more efficient grocery store as well as a more attractive outlet for consumers. If consumers are getting exactly what they want, perhaps the convenience of a Wal-Mart suddenly matters a lot less.  

In addition to improved loyalty programs, some supermarkets are investing in mobile applications to improve customers’ shopping experience. For example, Winn-Dixie is offering a free application that is updated every Wednesday with prices of weekly specials, as well as a virtual grocery list feature. Kroger also has an application that makes announcements about upcoming deals. As more consumers buy smartphones, experts expect this trend to become even more popular.

*Industry consolidation expected to slow*

Forecasts point to a slowdown in mergers and acquisitions (M&A) over the next five years. Experts point to the Federal Trade Commission's expected tightening of regulations in an attempt to maintain a competitive environment. To increase competitiveness, supermarkets will likely move to realign with changing demographics and undertake renovation activities. Experts believe stores will be more willing to improve existing stores than open new ones in untested locations as these regulations are

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63 Ibid
implemented. Still, some M&A activity is expected to occur as larger stores will always purchase struggling, smaller stores with adequate locations. As a result of large corporate takeovers, forecasts show that the number of industry enterprises is expected to decrease at an annualized rate of 0.6% per year in the five years to 2019 to 34,725. In parallel, employment is expected to decrease at an average rate of 0.1% per year during the five years to 2019 to an estimated 2.3 million workers. Overall, moderate industry growth is projected, with some expansion necessary for keeping up with the growing population.64

**Recommendations**

According to research from Booz & Company, some of shoppers’ value-seeking behaviors that they have learned during the recession have since become ingrained.65 Yes, they’ll buy more premium goods as disposable income increases, but they may do it for the best price they can find. Shoppers will bargain hunt and willingly visit numerous stores for the best deal no matter what moving forward. If this were true, why would Wal-Mart lose any of its monstrous market share? It already has a leg up in this category and provides a one-stop shop for price-conscious consumers. Additionally, digital technologies and smartphone usage will make bargain hunting even easier and more convenient, as consumers now have all of the best deals right at their fingertips.66 Why grab everything at Supervalu when Safeway has the cheapest milk and Wal-Mart has the cheapest bread? So how can traditional grocery stores compete?

1. A thorough understanding of the customer: Being able to react to a customer’s ongoing behavior is one potential way to differentiate. While a Costco may understand its

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64 Jeffrey Cohen. “Supermarkets and Grocery Stores in the US,” *IBISWorld* (January 2014)
66 Ibid
customer, a warehouse-type store can only take customization so far, as its end goal is still selling in bulk for cheap. An enhanced shopper loyalty program focused around advanced data analytics could allow stores to give customers exactly what they want when they want it.\textsuperscript{67}

This level of analysis is already being taken to heights that many analysts may not have ever considered in years past. Kroger has recently implemented architecture that may drive the store of the future through the use of ZigBee wireless mesh networks. ZigBee allows the store to integrate video analytics, wireless devices, POS devices, handheld sensors, scales, IP cameras, and Vigil360 video management software into a platform for retail applications, including loss prevention, store automation and analytics.\textsuperscript{68} Chris Hjelm, Kroger's SVP and CIO of Kroger, said, "Retail Site Intelligence is, above all, about customer first innovation. We are leveraging technology to help customers have the best possible shopping experience in retail stores, whether by more easily finding the products they want or saving time at checkout. We expect Retail Site Intelligence to be the cornerstone of the technology infrastructure for Kroger stores in the future."\textsuperscript{69} ZigBees and other likeminded software can help cut down costs by focusing on formerly manually-driven parts of the store – think setting the temperature of a freezer or monitoring theft – while also providing the store with real time video analytics. While a loyalty card reflects what a customer has purchased, the future may include a way to

\footnotesize{\textsuperscript{67} Nicholas Hodson, Thom Blischok and Matthew Egol. “Four Forces Shaping Competition in Grocery Retailing,” \textit{Booz & Company} (2012)\textsuperscript{68} Ibid \textsuperscript{69} Ibid}
analyze what the customer is thinking in real time, thus allowing each store to provide live feedback, maybe through coupon offerings as they peruse an aisle.\textsuperscript{70}

2. Digital and mobile marketing: While digital and mobile technologies are often still thought of as a one-size-fits-all approach today, retailers have the potential to tailor their applications and software to their brands. For example, a hi-lo retailer might leverage mobile technologies to deliver targeted manufacturer-funded deals while a premium outlet may offer help with fancier recipes and information about new or unfamiliar products. Additionally, it can be coupled with the aforementioned video analytics to offer real-time coupons and discounts. Perhaps a customer walks past the Oreo aisle. As an incentive to return, the mobile application will offer a coupon for Oreos, thus bringing them back to the selection. Even if the customer does not end up making the purchase, he may still head back to the aisle and is at least presented with the different offerings of the brand.\textsuperscript{71}

3. Multichannel retailing: Slowly but surely, many of the typical grocery categories are becoming the specialty of online retailers. Why go to a grocery store for pharmacy items when Amazon sells the same items in bulk for a far cheaper price? Traditional grocery stores need to find a way to keep up, and the best way is to protect themselves through an online outlet while still maintaining its brick-and-mortar grocery stores. According to Booz & Company’s report, “A true multichannel retailing capability integrates in-store, online, and digital mobile offerings to meet shoppers’ differing needs, supported by the appropriate back-office systems and supply chain capabilities.”\textsuperscript{72} Many grocery stores

\textsuperscript{70} Nicholas Hodson, Thom Blischok and Matthew Egol. “Four Forces Shaping Competition in Grocery Retailing,” \textit{Booz & Company} (2012)
\textsuperscript{71} Ibid
\textsuperscript{72} Ibid
already have passable online stores, but they are nowhere nearly good enough to make them a serious alternative to Amazon. Right now, Peapod and Safeway’s online services work well for busy families, but they are not yet suitable for everyone. With proper integration, there is a chance that grocery stores will be seen as a legitimate multichannel threat in the future. Grocery stores must follow Amazon’s lead with the implementation of something similar to the Dash. There needs to be a way to make online grocery shopping as quick and painless as possible. If someone wants a specific type of apple, just scan the apple you already have. Falling behind Amazon is something that simply cannot happen, as they have the resources to become a fully online grocery store.

4. Innovation: Finally, the Booz & Company report points to innovation in products and merchandising. The introduction of new, unique private-label products can help to differentiate the brand in shoppers’ minds and deliver distinctive value. Additionally, new merchandising platforms developed in collaboration with suppliers could serve to increase shopper conversion. Wal-Mart isn’t looking to push boundaries in a conventional way; perhaps they have superb IT infrastructure and smart people running the companies, but they are not trying to bring new products to the table. If a Safeway or a Kroger came up with something that people truly wanted and demanded, that would be reason enough for them to start their shopping trips at a grocery store, not at a supercenter. Costco already has proven success in this with its Kirkland offerings.

5. In-Store Improvements: Beyond cleaning up the behind-the-scenes customer experience, there is work to be done in improving the customer’s direct, explicit experience. Grocery stores like Wegman’s have already attempted to perfect the customer experience.

74 Ibid
experience, but there are still things that need fixing. More efficient self-checkout
registers would offer customers with the opportunity to forego any kind of customer
service, something that many people would love to do. Unfortunately, most stores make
this process extremely difficult with larger orders. A widespread shop-as-you-go tool
could help. Some stores already offer it, but it very rarely works or is worth it. Still, there
is potential in allowing customers to scan their items as they shop, thus making the exit
transaction nothing more than a swipe of a card. This lets customers get in and out as fast
as they want, something that is clearly of the utmost important to many these days. If
convenience stores are thriving due to the ease of the process, grocery stores need to find
a way to catch up.

**Conclusions**

While the grocery store industry is facing many potentially problematic trends, it
still has opportunities to retain its market share and possibly regain some of what it has
lost in recent years. The familiarity of the grocery store coupled with an updating of
many of the industry’s stale, tired tactics could place traditional grocery stores in a
position to thrive.
Bibliography


