The $400 billion US retail grocery industry includes about 40,000 companies that operate 70,000 grocery stores (excluding convenience stores). About 50 large national and regional chains like Kroger, Albertsons, Ahold, and Safeway hold more than 60 percent of the market. The industry is highly concentrated: 500 companies that own more than five stores control 80 percent of the market.

COMPETITIVE LANDSCAPE

Demand for food products is limited by the 1 percent annual growth of the US population. Profitability of individual companies depends on having the right product mix and on efficient operations. There are large economies of scale in operations and purchasing. Small grocers can compete effectively only by offering specialty products or better produce or special services such as take-out food.

The average supermarket of large chains has $14 million in annual revenue, and revenue per employee of $150,000. Companies with fewer than five stores have annual revenue per store of $6 million and revenue per employee of $130,000.

PRODUCTS, OPERATIONS & TECHNOLOGY

Grocery stores sell three major types of products: perishable foods (50 percent of revenue); non-perishable foods (30 percent); and non-food items (20 percent). Within the perishables’ category, the largest sellers are meats and poultry, produce, dairy, and frozen foods.

The operations of retail grocers involve wholesale buying of foods and other products, coordinating delivery to stores, handling and stocking, advertising and pricing, and managing labor. The typical supermarket is 45,000 square feet and carries 40,000 different items, or stockkeeping units (SKUs), but some markets are over 100,000 square feet.

While small chains and independent stores buy most products from wholesale distributors, big chains often buy directly from manufacturers. A grocery chain may buy from dozens of food distributors, either directly or with the aid of food brokers. Contracts with distributors may span several years. Some grocers
belong to buying **cooperatives** that deal directly with manufacturers. The biggest efficiencies for large companies arise from their substantial buying power and efficient distribution systems, which result in lower prices.

Most companies with multiple stores own one or several **distribution centers** (sometimes over a million square feet) that receive and redistribute merchandise for their stores using a fleet of trucks. Stores are usually within **250 miles** of the distribution center. Ingles Markets, a $2 billion chain, moves 67 percent of its product volume through its own distribution system, has 13 percent delivered directly to its stores by a national distributor, and 20 percent delivered by local manufacturers and distributors.

Large chains may leverage their distribution system by selling wholesale to other food retailers. Kroger, the largest supermarket operator in the US, is also one of the largest food distributors. Some companies operate their own bakeries and dairies. Large companies may operate a number of chains with different names, using a central distribution system to supply them all.

Because they have limited space to carry extra inventory, grocers rely heavily on their distributors for frequent deliveries.

**Inventory** management is very important to grocery retailers, both for efficiency and to identify products that are selling well or poorly. To track inventory and sales, supermarkets and grocery stores use **computer technology** such as scanners, and sophisticated point-of-sale, inventory, and reorder systems, extensively.

**SALES & MARKETING**

**Merchandising** (deciding which products to sell) and pricing depend very much on the demographics of the population surrounding a supermarket. Most companies study the economic characteristics of an area very carefully before opening a store. Stores will generally sell several brands of the same product, often including a private-label store brand that sells for less.

Marketing and promotion are through newspaper advertising, coupons, direct mail, store events, and special sales.

Store **layout** is key in funneling customers to higher-margin goods, like produce and bakery products. Average annual sales per square foot of selling space are about $500. Supermarkets typically serve customers within a 1- to 2-mile area.

**FINANCE & REGULATION**

Because of the very low profit margins on most grocery items (typically just a few percent of sales), companies need to move large quantities of product. Inventory turnover and cash flow are high. Industry net profit margins are close to 1 percent. Invoices from distributors are often paid within 10 days. Aside from the cost of goods sold, labor is the largest grocery expense, amounting to 40 percent of total food marketing costs. Because of uneven work requirements during the day, many supermarket employees work only part-time.

Stores and distribution **properties** are owned or leased. Owned stores may have additional real estate value in prime locations, but leased facilities offer more flexibility for chains that open many new stores. Some operators, like Ingles, own the shopping centers where their stores are located. Capital requirements may be high for supermarket chains that are growing rapidly or are remodeling.

Grocery stores are subject to **regulations** of state health departments, the Food Safety and Inspection Service of the USDA, the FDA, and OSHA.

**HUMAN RESOURCES**

Most jobs at supermarkets and grocery stores require relatively little expertise and are accordingly not well-paid. Most work involves restocking, cashiering, and bagging. A large number of employees work part-time and receive few benefits. Because of relatively low pay, many companies have high turnover.

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Industry Employment Growth
Bureau of Labor Statistics
Alternative Formats Flourishing - Traditional grocery stores face increased competition as a wider array of alternative retail formats try to add food and beverage to current offerings. These alternative formats include supercenters, wholesale clubs, dollar stores, limited-assortment stores, convenience stores, drugstores, and specialty stores. About 90 percent of all groceries were sold through traditional grocery stores in 1988, a number that has fallen to 55 percent in 2005. Analysts expect the figure to fall below 50 percent by 2008, meaning that grocers may have to compete based on price or services to maintain sales' levels from a shrinking customer base.

Solid Retail Sales' Growth - Hurricane Katrina and rising gas prices aren't negatively affecting retail sales, but grocery store sales are growing at a slightly lower rate than the overall retail sector. Total retail and food service sales through the first nine months of 2005 jumped 7.6 percent over the previous year; grocery store sales grew by 4.4 percent to $346.4 billion. The strong retail environment is a positive sign for grocery stores, but the lower comparative growth rate could reflect the continuing shift of food sales to alternative format stores such as supercenters and wholesale clubs.

In-Store Pharmacies Grow - Supermarkets are expanding their drugstore operations as a way to gain a competitive edge by addressing a customer need. Analysts predict that the number of pharmacies in grocery stores will grow by 4.9 percent in 2005, with the rate higher for independent grocery stores than chains. The average pharmacy size is also expected to jump from 475 square feet in 2004 to 538 in 2005 as stores add nutrition counseling, over-the-counter medications, and specialty services. Despite the growth, stores will be challenged by changing regulatory environments, the Medicare prescription drug benefit, and a national pharmacist shortage.

Stores Target Growth with Imported Specialty Foods - As the US customer base becomes more international and American-born customers seek new food experiences, the quality and availability of specialty import foods are becoming important competitive factors. The market for imported food and beverage products continues to expand rapidly after jumping from $49.7 billion in 2002 to $62.1 billion in 2004. To attract and retain customers in the segment, stores must offer authentic brands that customers recognize from living in or visiting foreign countries. Sourcing these products, however, can be challenging.
and often involves establishing relationships with multiple specialty distributors.

Focus on Whole Health Products - A growing number of consumers are focusing on an overall whole health approach to life, and many supermarkets are finding ways to promote whole health choices. Some stores are segregating their whole health offerings to create a distinct experience for this customer base, with Albertsons planning to roll out its Wild Harvest store-within-a-store concept nationwide. Other stores such as ShopRite are integrating whole health products with conventional products, creating a need to highlight and differentiate the products to drive trial and adoption. Retailers must devote significant time to choosing new products, with 98 percent of food manufacturers reporting reformulations and introductions of new products.

CRITICAL ISSUES

Competition from Mass Merchants - Mass marketers, like Target and Wal-Mart, are rapidly expanding their food sales. Warehouse stores and wholesale clubs, like Costco and Sam's, sell food in bulk at discounted prices. Wal-Mart has opened hundreds of "Supercenters" that combine a large food/drug store with other merchandise under one roof, attracting customers with low food prices. Grocery items account for about 30 percent of sales at Wal-Mart and Costco.

- Grocery store sales grew about 4.4 percent in the first ten months of 2005, but general merchandise store sales rose 6.3 percent.

Economies of Scale Favor Consolidation - The efficiencies in purchasing and distribution available to large food retailers in a low-margin business make competing solely on price difficult for smaller companies. Larger companies have expanded in recent years, mainly by acquiring local and regional chains. The 50 largest grocery chains hold more than 60 percent of the market.

- Ahold ranks behind Wal-Mart Stores, Carrefour, and Tesco Plc as the largest food retailer.

OTHER BUSINESS CHALLENGES

Low Population Growth - The US population grows at only 1 percent per year, limiting growth in the total food business.

Shrinking Share of Food Market - The percentage of food bought at food stores has been declining for decades, as changes in lifestyles have caused Americans to turn to other sources like restaurants, take-out, and convenience stores. In 2002, only 40 percent of food was bought at food stores, down from 45 percent a decade earlier.

Higher Risk of Food Contamination - As companies move larger amounts of non-preserved foods through their distribution systems, the likelihood of contamination increases. Despite new government and industry efforts, episodes of food-borne illnesses are still common.

Theft Losses - Shoplifting, check fraud, employee theft, and organized retail theft remain the greatest sources of annual losses for food retailers, according to Food Marketing Institute (FMI). The rising losses are forcing supermarkets to invest in new security and loss prevention methods, such as sensors in meats, biometrics, check authorization systems, background screening, access control procedures, video surveillance, and crisis management plans.

Increased Food Labeling Requirements - Food retailers are fighting the increase in laws and regulations being passed to increase the amount of information required on food labels, a result of consumers becoming more concerned with health issues and rising obesity rates. Recently, FDA passed requirements, effective 2006, to include on nutrition labels the amount of trans fatty acids found in thousands of foods.
BUSINESS TRENDS

Consolidation - In an industry with low margins where economies of scale are large, failure is frequent, and good management practices can make a big difference in profitability. Kroger adds an average of 50 new stores per year. Chains usually expand by building stores in new market areas, but may also buy a chain of stores and convert them, or buy an established competitor that they continue to operate. From 1997 to 2001, Safeway acquired five chains with 617 stores.

Strategic Store Layout - Conventional supermarkets are changing their layout to steer customers to the highest-gross-margin items (bakery – 40 percent; deli – 38 percent; produce – 30 percent) and to new high-margin services such as take-out, "natural" foods, salad bars, party planning, film processing, videotape rentals, and flowers. Even small chains now carry private label goods that have lower prices but higher margins than national brands.

Variety of Store Formats - Several different store formats have evolved recently to take advantage of changing consumer buying habits. A typical new store is less than 49,000 square feet, declining for the first time in five years. The largest section of the new stores is often bakeries (2,100 square feet). New stores frequently offer delis, fast food eating areas, pharmacies, health and beauty products, and gas pumps; 68 percent of new stores have pharmacies. Albertsons operates several different store formats, including conventional supermarkets, combination food/drug stores, and warehouse stores.

More Services - Grocery stores are adding new sources of revenue such as pharmacies, banking centers, take-home prepared foods, gas pumps, and dry cleaners. Some stores are going further, opening cafes, restaurants, and instore kitchens with chefs preparing gourmet specialties.

Centralized Buying - In a bid to match the buying efficiencies of giants like Wal-Mart and Costco, more supermarket companies are switching to a centralized purchasing system for perishables. Many other supermarket items are already being bought this way, but regional and local buying have been the norm for perishables.

INDUSTRY OPPORTUNITIES

Gasoline Sales - Big grocery chains use discount gas sales to draw customers. Kroger, the nation's largest grocery chain, has dozens of fuel centers and Albertsons sells gas at over 100 supermarkets.

Organic Products - Organic products are becoming more popular with consumers and often have high margins for grocers. New USDA standards create consistent labeling of organically grown foods and establish certification guidelines for organic crops, livestock, and processed products. Currently only 24 percent of food retailers have a natural food section.

Private Label Products - Larger supermarket chains offer private label brands, which sell for less but have better profit margins. Supermarkets have been upgrading the quality of their private label offerings; Kroger carries about 7,500.

Self-Checkout - As the technology improves and customer acceptance increases, more grocers are investing in self-scanning machines to speed checkout and cut labor costs. The retail industry expects the number of self-scanning machines in stores to double by 2007. Self-scanning has grown in various pockets around the country, and while it won't replace clerks, it usually occupies one or two aisles in stores that offer it.

Grocery Take-Out - Many supermarkets offer hot and cold take-out meals, which have high profit margins. Customers can either order in the store or call ahead of time. A drawback is that sales are only high around dinner time.

Prepared Foods - Prepared foods have become more popular with consumers who want to use prepared ingredients when they cook. Supermarket sales of prepared refrigerated foods are expected to grow to over $12 billion by 2005, prompting stores to invest more in refrigeration and freezer space. Among the fastest-growing products are prepackaged salad products, meats and poultry, and prepared produce.

Loyalty Cards - Supermarket loyalty discount cards, which almost every grocery store chain uses, are being protested by those who claim that the personal data and shopping information collected violates privacy rights. Stores, using cards to track purchase histories, are beginning to segment customers into groups based on how much and how often they purchase. Such information helps target desirable
customers and cater to their needs.

**Internet Ventures** - The failure of pure Internet grocers hasn’t deterred bricks-and-mortar supermarkets from rolling out their own online ordering systems, with orders filled from grocery store shelves by store employees and picked up by the customer or delivered for a fee.

**CONVERSATION STARTERS**

**How does the company differentiate itself as competition grows?**
Mass marketers, like Target and Wal-Mart, are rapidly expanding their food sales.

**How is consolidation affecting the company’s market?**
The efficiencies in purchasing and distribution available to large food retailers in a low-margin business make competing solely on price difficult for smaller companies.

**What effect, if any, is slow population growth having on company expansion and revenues?**
The US population grows at only 1 percent per year, limiting growth in the total food business.

**What advantages or challenges do adding gas pumps present for the company?**
Big grocery chains use discount gas sales to draw customers.

**What benefits does the company see in offering or expanding its organic food selection?**
Organic products are becoming more popular with consumers and often have high margins for grocers.

**How successful are the company’s efforts to sell private label products?**
Larger supermarket chains offer private label brands, which sell for less but have better profit margins.

**QUARTERLY INDUSTRY UPDATE QUESTIONS**

**How is competition from alternative formats affecting the business?**
Traditional grocery stores face increased competition due to a wider array of alternative retail formats including supercenters and wholesale clubs. About 55 percent of all groceries were sold through traditional grocery stores in 2005, down from 90 percent in 1988.

**How do in-store pharmacy operations factor into the company’s growth strategy?**
Analysts predict that the number of pharmacies in grocery stores will grow by 4.9 percent in 2005, with the growth rate higher for independent grocery stores than chains. Average pharmacy size is also expected to increase as stores add nutrition counseling, over-the-counter medications, and specialty services.

**OPERATIONS, PRODUCTS AND FACILITIES QUESTIONS**

**How many stores does the company have? What size (square feet)?**
The typical supermarket is approximately 45,000 square feet.

**How many products in each store (stockkeeping units, "SKUs")?**
The typical supermarket carries 40,000 different items.

**What are average sales per square foot?**
The industry average is about $500.

**Are the stores conventional, food/drug combinations, warehouse, or some other format?**
Several different store formats have evolved in recent years to take advantage of changing consumer buying habits.

**Does the company operate a warehouse/distribution center? How big is the center? What percentage of store products moves through the warehouse?**
Most companies with multiple stores own one or several distribution centers (sometimes over a million square feet) that receive and redistribute merchandise for their stores using a fleet of trucks.
What percentage of products is bought from wholesalers?
Small chains and independent stores buy most of their products from wholesale distributors; big chains save by buying directly from manufacturers.

What percentage of products is bought directly from manufacturers?
Most big chains save by buying directly from manufacturers.

How does the company avoid unfilled orders from distributors?
Grocery stores may need to find additional distributors from different parts of the country to fill orders if existing distributors have access to only limited products.

Does the company sell (higher margin) private label brands? What percentage of sales is private label?

Does the company plan to add nonfood products and services in its stores?
With grocery sales slow, grocers have added a variety of goods and services.

Does the company operate its own bakery, dairy, ice cream plant, juice bottling, other?
Some companies operate their own bakeries and dairies.

What percentage of store products are perishables, like meats, produce, bakery, dairy, deli, frozen?
The national average for perishables is about 49 percent.

Does the store offer value-added convenience products, like sliced fresh fruit?
Industry estimates show that "fresh-cut" produce has grown more than 17 times in just three years. For some chains it's the most profitable item in the produce department.

Does the company offer self-checkout?
A package of four self-checkouts and an attendant station costs about $100,000.

CUSTOMERS, MARKETING, PRICING, COMPETITION QUESTIONS

What sorts of customers does the company attract to its stores?
Companies often target a specific demographic group.

What kind of consumer research does the company do?
Examples include surveys, suggestion boxes, consumer help desks, and computer tracking of buying trends.

What sort of marketing and advertising does the company do?
Examples include newspaper, TV, radio, direct mail, events sponsorship, community participation, and telemarketing.

How does the company roll out new products in stores?
When a new food product is introduced, supermarkets face the difficult task of figuring out where the new item will fit into the merchandise mix in their store layout.

How does the company use the data collected from purchases that use loyalty cards?
Customer loyalty card data could be used to tailor prices to individual shoppers, called customer-specific marketing, to target desirable customers and cater to their needs.

What is the company's main competition?
Regional grocery store chains are especially threatened by each other, and larger supermarket franchises, and outside competition, like superstores, drug, convenience, and discount stores.

REGULATIONS, R&D, IMPORTS, AND EXPORTS QUESTIONS

Has the store's management created specific policies concerning potential food contamination?
As companies move larger amounts of nonpreserved food products through their distribution systems, the likelihood of contamination increases.

Has the company had any contamination problems?
ORGANIZATION AND MANAGEMENT QUESTIONS

How does the company find workers?
Of all supermarket expenses, store labor accounts for the largest portion: 39 percent of the total cost of food distribution, according to the USDA.

How many employees are part-time versus full-time?
Because of uneven demand during the day and week, many employees work part-time.

How does the company choose locations for new store development?
Supermarkets usually draw customers within a one- to two-mile area.

FINANCIAL ANALYSIS QUESTIONS

How variable is the company's cash flow during the year?
Cash flow is usually fairly even, with surges around holiday seasons.

How large are inventories as a percentage of sales?
Less than 10 percent is typical.

Does the company have long-term contracts with suppliers?
Contracts may extend over several years.

Are stores and equipment owned or leased?
Stores and distribution centers may be owned or leased. Leased facilities offer more flexibility for chains that open many new stores. Some operators, like Ingles, own the shopping centers where their stores are located.

What is the average payment time on deliveries?
The industry average is under ten days.

How does the company manage daily cash flow?
Supermarkets have high cash flow.

BUSINESS AND TECHNOLOGY STRATEGIES QUESTIONS

Are the company's stores in high- or low-growth areas?

Does the company have expansion plans?
The large chains have been expanding rapidly in recent years.

Has ownership changed in the company's major markets?
The large chains continue to make acquisitions.

How often are stores remodeled?
Industry experts estimate that a typical store requires remodeling ten years after it opens and every seven thereafter.

Does the company plan to remodel any of its stores in the near future?
Although major store remodeling rates have slowed in recent years, the percentage of supermarkets remodeling has actually increased.

Does the company have an Internet site?
Some stores allow customers to shop, order cakes and cuts of meat, and print coupons over the Internet.

Does the company use frequent shopper cards, or other incentives for loyalty?
Many customers have several supermarkets available to them.

What type of system does the company use to reorder products?
Many companies have electronic data interchange with suppliers to automatically replenish inventories.
US personal consumption expenditures of food, a major driver for grocery stores and supermarkets, are forecast to grow at an annual compounded rate of 3.3 percent between 2005 and 2008.

**Flat Consumer Spending Growth on Food**

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<tr>
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Source: IERF, Inc.

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