Nontraditional Retailers Challenge the Supermarket Industry

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Recent growth in sales of nontraditional retail outlets—membership warehouse clubs, mass merchandisers, and deep-discount drugstores—has caused traditional grocery food stores to modify marketing strategies and appeal to the more price-conscious consumer.

While nontraditional outlets do not generally offer the broad array of produce, bakery products, fresh meats and dairy products, and frozen foods found in traditional foodstores, they do market large amounts of specific categories of products—such as dry groceries, health and beauty products, and general merchandise.

According to a recent Food Marketing Institute (FMI) report on alternative store formats, grocery sales of nontraditional retail outlets rose to $33.3 billion, or 6.2 percent of all grocery sales in 1991. The growth has primarily occurred within the last 5 years, but a rapid increase is expected through the end of the decade.

Because these outlets are more specialized, have lower operating costs, and subsequently offer lower prices to consumers, they are taking business away from some nearby supermarkets. Competition between traditional and nontraditional food operators, aided further by the recent recession, continues to increase as the nontraditionals expand into other traditional grocery departments, such as fresh produce and fresh meat.

In 1980, there were only eight wholesale clubs in the entire food retailing industry. In early 1993, there were 779, with an estimated combined annual sales of $34.2 billion in 1992. Mass merchandisers, such as Kmart and Wal-Mart, and deep-discount drugstores, such as Phar-Mor, Drug Emporium, and F&M, also sell increasing amounts of groceries, such as snacks, beverages, and canned and other packaged food products. Additionally, the new Kmart and Wal-Mart su-

Although still the central force in today's grocery market, supermarkets have had to adjust to keen competition in food retailing. Their services, bulk food sales, and "warehouse" pricing have helped.

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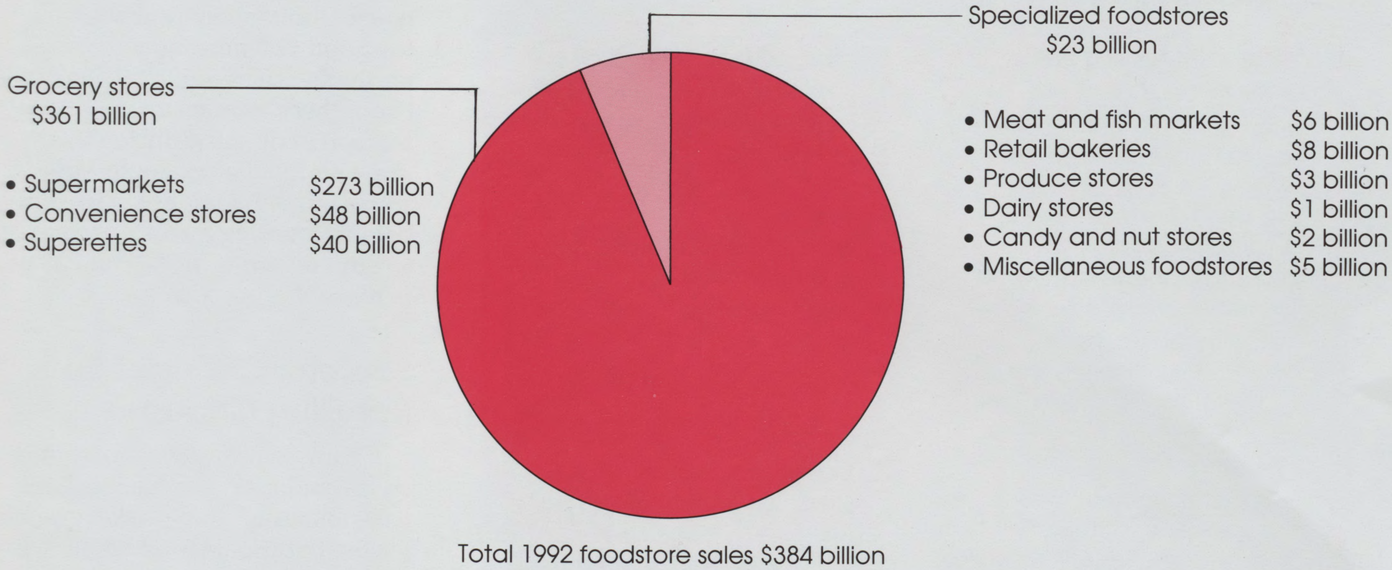
Figure 1

Supermarkets Accounted for Over 70 Percent of Foodstore Sales in 1992



Source: *Food Marketing Review, 1992,* forthcoming by USDA's Economic Research Service.

percenters include full-line grocery stores, making competition in food retailing keener than ever.

Traditional Supermarkets Still Dominate

The traditional food retailing industry comprises a range of foodstores. These retailers include broad-line grocery stores—supermarkets, convenience stores, and superettes—and specialty foodstores, such as meat and seafood markets, produce stands, delicatessens, and bakeries. Total foodstore sales for 1992 were $384 billion. Grocery store sales at $361 billion accounted for 94 percent of this total, while specialty foodstores had a 6-percent share (fig. 1).

The supermarket, the central force in today's grocery market, is primarily a self-service grocery store with a full range of departments and annual sales of at least $3.3 million in 1992. Additionally, 50 percent or more of supermarket sales come from food. Supermarkets accounted for over 70 percent of total foodstore sales and 76 percent of grocery store sales in 1992.

Supermarket formats include conventional supermarkets, superstores, combination food/drug stores, limited assortment stores, warehouse stores, and hypermarkets (see box). Each format is distinguished by size, percentage of food versus nonfood items offered, and variety of services.

The conventional supermarket was once the most common format. In 1980, 85 percent of all supermarkets fit the conventional format, accounting for 73.1 percent of grocery store sales (table 1). By 1991, only 49 percent of supermarkets were conventional, accounting

Table 1

Conventional Supermarkets' Share of Sales Has Declined

Supermarket format	Share of supermarkets 1980	Share of supermarkets 1991	Share of supermarket sales 1980	Share of supermarket sales 1991
	Percent			
Conventional	85.0	49.5	73.1	30.4
Superstore	8.9	24.9	17.7	33.9
Combination food and drug	.9	8.9	4.0	17.1
Warehouse/limited assortment	4.7	14.6	4.2	13.1
Superwarehouse	.5	2.0	1.0	5.1
Hypermarket	NA	.1	NA	.3

Note: Data may not sum to 100 due to rounding. NA= Not applicable.
Source: *Food Marketing Review, 1992,* forthcoming by USDA's Economic Research Service.

Coming to 'Terms' with Traditional Supermarket Formats

Combination food and drug store
- More product variety than in conventional supermarkets
- Nonfood items capture 25-35 percent of sales
- Nonprescription drugs and general merchandise
- Prescription drugs
- Size typically ranges from 35,000 to 45,000 square feet

Conventional
- Highest percent of food versus nonfood items
- Size typically ranges from 3,000 to 30,000 square feet
- All major store departments represented

Hypermarket
- 100,000 square feet or more in size
- Up to 40 percent of sales in general merchandise items
- Patterned after the European hypermarket concept

Limited assortment store
- Limited number of product brands
- Most popular sizes stocked
- Less than 10,000 square feet
- Little or no raw, perishable products

Superette
- Annual sales below $3.3 million in 1992
- Wide variety of food/nonfood
- Primarily self-service

Superstore
- Larger deli, bakery, and specialty product departments
- Some self-serve bulk foods
- Average size 35,000 square feet
- General merchandise

Warehouse store
- Strong price appeal
- Size ranges from 12,000 to 35,000 square feet (super warehouse stores range from 50,000 to 140,000 square feet)
- Primarily food and some health and beauty aids, but low emphasis on general merchandise

for 30.4 percent of supermarket sales.

A conventional supermarket is basically self-service, and foods and beverages dominate the stock. It sells meat, produce, bakery, and other food and grocery related products as well as nonfood items such as soaps, detergents, and paper products. Items are generally prepackaged or individually packed and displayed throughout the store. Store sizes typically range from 3,000 to 30,000 square feet and carry from 9,000 to 11,000 items. The selection of nonfood products in conventional stores is limited.

The other supermarket formats are larger or offer more variety, specialty foods, prescription and nonprescription drugs, or other features or services (see box). These other formats gained in sales shares and numbers over the last decade. Between 1980 and 1991, superstores, combination food/drug stores, superwarehouses, and warehouse/limited assortment stores captured 42.3 percent of total supermarket sales (table 1). The number of these formats in operation more than doubled during this same period. For example, superstores more than doubled in numbers, accounting for 24.9 percent of all supermarkets in 1991 and 33.9 percent of grocery sales.

Societal Changes Spur Retailing Changes

Changes in the work force, lifestyles, and economic factors have contributed to slow market growth for the traditional food retailing industry and to the increase in larger, more diversified stores over the last two decades. The increase in multiple-career households meant more disposable income, coupled with the demand for more convenience, quality, and time savings.

Retailers seeking new opportunities for greater sales to price- conscious consumers as well as service-oriented consumers responded with new supermarket formats and services to challenge the conventional supermarkets.

Many supermarkets pursued the "one-stop shopping" concept by providing expanded service departments (meat, fish, and deli), and expanded nonfood departments and services, such as pharmacies, video rentals, nonprescription/prescription drugs, and general merchandise, such as clothing.

Competition was also sharpened by the recent recession and slow-paced recovery. Per capita disposable income, adjusted for inflation, rose 1.1 percent in 1992 from a previous drop of 1.3 percent in 1991. The 1992 food price increase was the lowest since that in 1967.

Nontraditional Retail Outlets Move Into Territory

Added to these economic pressures was the growth of lower cost, price-oriented nontraditional outlets. Generally known to stock a high percentage of general merchandise, these outlets have expanded their offering of groceries and related products.

These formats have grown rapidly and, for the most part, profitably, over the last several years. Besides other benefits offered to consumers, they are noted most for offering low prices.

Membership Warehouse Clubs

Considered one of the fastest growing segments of retailing, according to *Progressive Grocer* magazine, the first membership warehouse club store opened in San Diego, California, in 1976. The Price Company opened Price Club, designed to appeal to a select group of individuals and small businesses looking to save money.

Warehouse club stores were fully computerized, no-frills operations offering a limited selection of first quality, name- brand merchandise. Grocery products were mainly dry groceries and paper products. Today, club stores have expanded their offerings to include some services and perishable foods.

Warehouse clubs stock fewer items than do traditional supermarkets, but they concentrate on high-value, branded items displayed on pallets and packaged in large, multipack sizes. They also offer fewer services than do supermarkets: there is no bagging, and operation hours are shorter.

Warehouse clubs also incur lower expenses for advertising, administration, and shipping, resulting in lower overall operating expenses compared with those of supermarkets. The clubs pass on these savings to shoppers through lower prices. An FMI study concluded that prices in club stores for grocery-related items averaged 26 percent lower than in traditional grocery stores.

More than 21 million people have memberships in U.S. warehouse clubs. Club sales totaled $34.2 billion in 1992. According to FMI, sales growth of warehouse clubs has averaged 31 percent over the last 5 years. Four firms accounted for over 90 percent of total sales (table 2).

Target areas for growth are those with populations of 400,000 or more.

Deep-Discount Drugstores

Deep-discount drugstores are known for their low-price image. They offer a broad selection of products—mainly health and beauty care products and general merchandise, such as small household appliances; some food items, such as candy and other snacks; and a limited assortment of popular, shelf-stable, high-volume foods. Located mainly along the east coast and in the Midwest in high-traffic shopping centers, these stores vary in business style. Store sizes range from 25,000 to 65,000 square feet. They generally stock a

Table 2
Membership Wholesale Clubs Have Become a Growing Retail Force

Club	1992 sales	Share of sales	Units		
			1992	1993	1994*
	Million dollars	*Percent*	*Number*		
Sam's Wholesale Club	12,339	36.1	208	256	305
The Price Club	7,480	21.9	88	94	102
Costco Wholesale Club	6,620	19.4	91	100	110
Pace Membership Warehouse Club	4,358	12.8	87	115	137
BJ's Wholesale Club	1,760	5.2	29	39	54
Smart & Final	752 *	2.2	116	125	139
Mega Warehouse Foods	293	.9	14	22	31
Warehouse Club, Inc.	241	.7	10	10	10
Wholesale Depot	200 *	.6	4	8	15
Club Aurrera[1]	60 *	.2	2	3	8
Price Club of Mexico	40 *	.1	0	1	3
H-E-B Bodega	10 *	**	2	2	1
Source Club	1 *	**	0	3	7
Price Rite	4 *	**	0	1	1
Total	34,167	100	651	779	923

Note: Percentages may not total 100 due to rounding. *Estimate. **Less than 0.1 percent.
[1]A joint venture between Wal-Mart and Mexico's CIFRA, N.A. Source: *Food Institute Report*, March 8, 1993.

Table 3
Warehouse Clubs Show Low Operating Expenses and High Returns

Financial returns[1]	Traditional grocery stores	Membership warehouse clubs	Deep-discount drugstores[2]
		Percent	
Return on invested capital	21.2	39.0	22.6
Earnings before interest and taxes	3.5	3.5	4.0
Gross margin	25.3	11.0[3]	20.0
Operating expense	21.8	7.5	16.0
Ratio of working capital to sales	1.7	-.7	13.2
Ratio of invested capital to sales	16.5	9.0	17.7
Ratio of fixed assets to sales	14.8	9.7	4.5

[1]1991, estimated. [2]Figures represent leading discounters. [3]Includes 2-percent revenue from membership fees. Source: Food Marketing Institute, 1992.

Table 4
Wal-Mart Led the Way in Sales by Mass Merchandisers

Company	1991 sales
	Million dollars
Wal-Mart[1]	31,667
Kmart[2]	24,749
Target	9,041
Ames	2,819
Caldor	1,868

[1]Discount store sales only. [2]U.S. stores only. Source: "Warehouse Clubs Lead Discount Industry Growth," *Food Institute Report*, July 25, 1992.

variety of brands in limited sizes and negotiate with manufacturers to obtain low costs or bargain for close-out items to keep costs low.

Like warehouse clubs, deep-discount drugstores have lower labor and fixtures' costs than do supermarkets. Gross margins (retailer markup over cost as a percentage of total sales) are higher than those for membership warehouse clubs, but less than those of grocery stores (table 3).

The three largest deep-discount drugstore firms are Phar-Mor, Drug Emporium, and F&M.

Mass Merchants

Mass merchandise stores offer an array of general brand-name merchandise and some private (or store) label goods, grocery related products, and snacks and dry groceries. New stores often exceed 100,000 square feet and stock between 70,000 and 80,000 products. They are largely located in small towns and large suburbs. Mass merchandise stores emphasize "every day low prices," and are increasing the number and variety of grocery products offered.

Wal-Mart and Kmart are the largest mass merchandisers. Wal-Mart's 1992 sales reached $43.9 billion, up 38 percent from 1991. Kmart followed, with $25.3 billion in sales (table 4). Wal-Mart and Kmart now operate supercenters—merchandise stores averaging 160,000 square feet with full-line supermarkets. Wal-Mart operates 60 supercenters across the Southeastern and Southcentral States (Arkansas, Texas, Oklahoma, Mississippi, Kentucky, Tennessee, Alabama, and Missouri). Kmart operates four supercenters in Ohio, North Carolina, and Mississippi.

Some of the top mass merchandisers generate as much as 25 to 30 percent of their sales from grocery-related products. They carry so-called "impulse" food items, such as snack foods and other shelf-stable foods, which require little labor and sell quickly.

Traditional Supermarkets Respond

Traditional supermarkets are responding in several ways to consumers who look to warehouse clubs and other nontraditional retail outlets for lower prices.

Meijer, a privately held combination food/drug store chain based in Grand Rapids, Michigan, has created a membership warehouse division called SourceClub. It opened in 1992, and marked the first time a grocery chain has entered the warehouse club market. Big V supermarket of Florida, New York, also opened Price Rite as its new club division in 1992.

Other supermarkets have expanded their product lines to include multipacks and bulk items. Giant Foods of Landover, Maryland, has a "Super Deal" section featuring bulk and multipacked, brand- name and private-label products at prices comparable with (and sometimes lower than) membership club prices. An Albertson's store operator in Bellevue, Washington, uses a similar approach to compete with a nearby Costco warehouse club competitor by offering economy-packed boxes of fresh produce. One small Lucky Stores operator in West Los Angeles, California, promotes "Key Buy" specials which offer lower discount prices than its area competitors for specific national brands. Another larger, more modern Lucky store in the same city includes a "Max Pak" section with bulk items displayed on pallets. Promotional advertising for this section suggests "saving the convenient way."

Supermarkets are promoting their advantages over warehouse clubs as a way to respond to competition. Longer hours of operation, convenient locations, no membership fees, and more variety are some of the advantages offered. Chester's Market, an independent operator in East Windsor, Connecticut, promotes its reputation for providing "friendly, knowledgeable service" to its customers, according to *Progressive Grocer* magazine. Chester's emphasizes its catering, birthday cakes made to order, special store coupons, and courteous telephone service.

Competition To Stiffen

Many food retailers are seeking to lower costs in order to compete with the nontraditional formats. Supermarket retailers may ultimately be forced to lower margins and prices in a number of categories, including personal care products, nonprescription drugs, paper products, and laundry and household supplies.

Nontraditional retail outlets will continue moving into supermarkets' territory with more new stores and more food items. For example, many warehouse clubs have added fresh bakery, meat, poultry, fish, and produce, as well as more nonfood services like film developing, car-buying programs, optical departments, and travel services. However, as these more labor-intensive services are added, costs and gross margins will increase. At that point, clubs will have to find new ways to keep cost advantages in these departments.

"One thing is certain: nontraditional retail outlets are having a significant impact on the traditional supermarket industry— and the industry is listening."

Increased competition among warehouse clubs in the same market could result in new marketing strategies to attract new customers. Future growth will be concentrated in small markets where there is less competition. More clubs are expected to expand operations outside the United States. For example, Price Club and Costco already have Canadian units, and Wal-Mart and Price Club have joint ventures with Mexican firms and plans for operations in other countries. Industry sources forecast growth in warehouse clubs to 950 stores by the year 2001.

Among mass merchandisers, Wal-Mart plans to open 30 new supercenters in 1993. Kmart also plans to open 15 similar stores this year, called Super Kmart Centers, with plans for another 70-80 supercenters to open in 1994. Kmart also is expanding the grocery department in all of its 2,300 stores and will offer a mix of branded and private-label nonperishable products. This is part of a $2.5-billion chainwide refurbishing program planned for completion by 1995.

In the case of deep-discount drugstores, some industry watchers speculate that growth may slow in the future. Drug Emporium opened 39 stores between 1990 and 1991, compared with only 6 new stores as of August 1992. It also posted a $4.7-million loss for the fiscal year ending February 1992. Phar-Mor filed Chapter 11 bankruptcy in August under allegations of mismanagement and closed 55 stores by the end of 1992, with plans to close another 31 this year.

Despite the current problems of some of the larger deep discounters, the prospects of market saturation, and other factors of competition, the future of the nontraditional retail outlet is bright. One thing is certain—nontraditional retail outlets are having a significant impact on the traditional supermarket industry, and the industry is listening.

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