Research Reports and Updates

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The Emerging Food Store Delicatessen: Some Preliminary Economics

by

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Since the mid-1970s there has been an expanding interest on the part of both consumers and food retailers in "service departments." A host of factors can be cited to explain this change, but continued strong consumer preference for convenience and healthful foods coupled with retailer attempts to improve profitability through differentiation lead the list (see McLaughlin and German for a more complete discussion of the forces shaping change in the contemporary food distribution industry). Yet, despite the increased activity in service departments, and because of their recent arrival in most food stores, relatively little is known about the actual economics of many of these departments, or about the factors required for successful operation.

Nature of Study

A research project was developed in an attempt to provide an information base to address the increasing number of questions regarding the economics of service departments. To lend focus to the initial inquiry, the scope of the study was limited to what many in the food retailing industry regard as the most dynamic of the service departments, the delicatessen. Information for the study was collected from survey questionnaires administered principally at two levels: food retailer headquarters and consumers. In a nationwide purposive sample of retailers, primarily large food chains, senior food chain management and deli directors were questioned regarding current deli operations and strategies. In a parallel survey, consumers were interviewed regarding their shopping behavior and perceptions vis-a-vis the deli. In the recently completed first phase of data collection, 15 major markets were visited. In total, 106 food chain and delicatessen executives, representing 31 major retail organizations, are included in the sample. In 1984 these retail firms accounted for nearly 10,000 retail stores and approximately $87 billion in sales, or about 44 percent of all supermarket sales. Approximately 500 consumers, from 10 of the market areas, were also personally interviewed.

Unless otherwise indicated, all of the data and other discussion in this paper are derived directly from the field work in this study. The paper reports several preliminary results of the study, organized into the following three sections: (1) Growth of the Deli, (2) Key Cost Components and (3) Pricing Practices.

Growth of the Deli

The in-store service deli is one of the fastest growing departments in the retail food store (Progressive Grocer, July 1985). Although service delis appeared in supermarkets in the New York City marketing area as early as the 1930s, these delis offered only a few basic products such as boiled ham, bologna and a very limited variety of cheese (Eastern Dairy-Deli Association, 1985). For much of the rest of the country, delis in their current form were virtually non-existent as recently as the mid-1970s. In fact, the largest growth of the in-store deli as an integral part of the supermarket may have actually occurred during the 1980s. Since the modern in-store deli is a recent phenomenon, historical data on deli operations are scarce. However, number of supermarket delis, total deli sales and sales per store have all grown in real terms since 1982 (Table 1). Moreover, many senior food retailing executives interviewed for this study indicated that in the future much more dramatic growth should be expected.

Deli growth during the 1980s has been directly tied to the development and expansion of new types of supermarket formats, such as the super store, the super warehouse store and the combination store. The deli has become an integral part of these recent supermarket hybrids for three principal reasons:

First, the considerable impact of changing consumer demographics and lifestyles on food purchasing and consumption behavior has been well documented by researchers and food industry analysts (see, for example, Zeithaml; Atlas). It has been suggested that the deli is perfectly positioned to meet the demands of today's consumers for fresher, higher quality products in more convenient forms than traditionally offered by most supermarkets. Contemporary values and lifestyles, including more mobile consumers, more women working outside the home, smaller households and generally greater concerns with health, nutrition and quality of food products have helped propel the growth of delis in supermarkets.

Second, whereas the average supermarket occupied less than 20,000 sq. ft. in the 1960s, the average supermarket by 1983 had grown to 28,000 sq. ft. (FMI, 1984) and the average new supermarket totaled 38,000 sq. ft. (FMI, 1983). In some instances, shoppers have criticized this increase in size since many view these larger stores as impersonal and imposing. However, small boutique-like shops within stores, such as the deli, can provide personal service that tend to offset the barn-like impersonal atmosphere of many dry grocery departments. For these reasons many food retailers have recently positioned their firm's "image" around the perishables departments in their new, generally larger, store formats.

Table 1.

Selected Measures of Deli Growth, 1982-1984

	1982	1983	1984
Total food store deli sales (000)	$3,970,000	$4,590,000	$5,170,000
Stores with delis	14,700	15,900	16,700
Average weekly deli sales per store	$ 5,200	$ 5,555	$ 5,950

Source: Supermarket Business, July 1985

Table 2

Changes in Supermarket Formats, 1984-1990

	Number of Stores		
	1985	1990	Change
Conventional Supermarkets	19,250	16,500	(2,750)
Superstores	4,800	6,100	1,300
Combination Stores	1,025	1,400	375
Super Warehouse Stores	110	350	240
Hyperstores	60	150	90
Club Membership Stores	100	425	325
Other	3,525	3,050	(475)
Total	28,870	27,975	(895)

Source: Willard Bishop Consulting Economists, Ltd., 1985

Table 3

Total Number of Delis in Supermarkets, 1982-1990

	1982	1983	1984	1985*	1990**
Number of Delis	14,700	15,900	16,700	17,500	22,030

* Estimated
** Cornell projection

Source: Supermarket Business, July 1985

Third, the deli, along with most other expanded perishable departments in the new supermarkets of the 1980s, is extremely important to the profitability of the overall store. The merchandising strategy of many of today's new supermarket formats places great emphasis on low prices and margins in the grocery department. This, relative at least to historical standards, results in lower grocery department profits. Data from the sample of firms in this study indicate that in 1984 the average gross margin in the deli was approximately 44 percent (Cornell Survey, 1985). This compares with a storewide margin average of approximately 23.89 percent (German, McLaughlin and Hawkes, 1984). Such high profit margins help offset the traditionally lower margins in the grocery department.

There were nearly 29,000 supermarkets in the United States in 1985. This number is expected to decline slightly by 1990 (Table 2). More importantly, a shift is predicted in the format of the typical supermarket by the next decade. Between 1985 and 1990 conventional supermarkets are expected to decline by 2,750 stores, from 19,250 to 16,500. Yet, during this same period, over 2,300 new stores including super stores, super warehouse stores and combination stores are expected to open (Table 2). Nearly all of these new stores, according to the consensus of industry executives interviewed for this study, sill be designed to accommodate in-store delis. It is also estimated that about 3,000 conventional supermarkets will be remodeled and upgraded during this period. This survey indicates that these stores too will contain delis. Therefore, a conservative projection suggests that between 1985 and 1990 over 5,300 additional delis will open in U.S. supermarkets (Table 3).

Key Cost Components

Labor: Most deli executives agree that the most critical factor in operating a successful supermarket deli is labor. The deli is essentially a service department; it exists to provide customers with products prepared and packaged to their own unique specifications. Top retail management increasingly expects the "service" departments to provide the differentiation for which today's retailers increasingly strive. Supermarket delis have responded by offering services not found in other departments; from custom slicing of meats and cheeses to special occasion catering.

Labor requirements for full-service delis are generally higher than for any other department in the supermarket. The current survey reveals that labor costs in the deli are 21.7 percent of sales, compared with an average storewide labor cost of only 9.97 percent (German, McLaughlin and Hawkes, 1984).

Deli labor expenses, as a percent of sales, were more than twice the storewide average for a number of reasons. In addition to the expense associated with maintaining an adequate deli staff, many companies also report a high turnover rate for deli employees relative to other departments. This is generally due to the large number of part-time employees in the deli. Data from this study reveal that 2.8 full-time and 8.4 part-time workers are employed by the average food store deli. Part-time deli labor often includes students or individuals working part-time while seeking better full-time positions. Employers in this study often expressed a desire to retain as few full-time people as possible, primarily because labor costs and employee benefit expenses are thus reduced. This approach to staffing may save labor expenses in the short run, but will probably cost considerably more in terms of higher employee turnover, the cost of new employee training, and additional sales that might otherwise be obtained by a more committed and loyal deli staff.

Managers in this study reported that initial selection of employees constituted another key variable critical to a successful deli. In addition to being personable toward customers, the deli staff must be knowledgeable about all products carried in their department (sometimes running as high as 1000 different items). They must also be creative and innovative in their merchandising techniques and, often, in product preparation. The personal contact with customers by staff in this department offers the opportunity for suggestive selling, often not possible in other departments. Deli employees are also increasingly used as "store representatives" since they are often the only personal contact, other than with cashiers, that a customer has in the store.

High labor costs coupled with the "image" importance of the deli staff underscores the critical need for training. Deli executives in this study indicated that by far the most popular training method for deli staffs was on-the-job training (OJT). For some companies, however, OJT represents the extent of the deli employee training program, while for others OJT is supplemented with deli manuals, seminars and other audio-visual techniques. A number of deli videos, for example, have been developed in recent years covering issues such as deli sanitation, equipment use, safety and service.

Interviews with retailer headquarters executives indicated, in certain cases, the presence of unequal wage and benefit structures between supermarket departments. Wages and benefits for deli staff in many companies, for example, often lag behind those for other departments. In most instances this inequity seems to be present because the deli department is new to the supermarket company and both employees and managers have less seniority and are at the lower end of the pay scale. However, given the increasing prominence of the deli in many retailers' current merchandising strategies, along with the inherent complexities of managing more employees than any other food department, it seems reasonable to expect the deli manager's salary will be brought into line with other department managers in the near future.

<u>Shrinkage</u>: "Shrinkage," the industry term encompassing all forms of sales lost due <u>inter alia</u> to product deterioration, errors or theft, is a key cost issue in a highly perishable department such as the delicatessen. Data from this survey indicate an average store-level deli shrink/loss factor of 4.88 percent of sales, or approximately $16,000 in lost sales per year. The range around this average was considerable, however: the lowest reported shrink/loss figure was .5 percent, while the highest was 10 percent of sales. This compares with an average "shrinkage" of approximately .6 percent for the entire store (FMI, 1984).

Shrinkage and loss figures for in-store delis vary according to a number of factors. First, the variety of products carried has a direct influence on loss. Deli executives reported adding considerably to the variety in their offerings during recent years: in 1984-85, the average number of deli products for the sample in this study was 297 (Cornell Survey, 1985). Moreover, such items as salads and hot foods, for example, have significantly higher shrinkage than do meats, cheeses, baked goods and desserts. Yet salads and hot foods are two of the most rapidly expanding sections of the deli. Thus adding such highly perishable items while attempting to reduce losses represents a significant challenge to today's deli industry.

As a result of the considerable magnitude of these costs, deli training programs frequently include a host of topics with the objective of reducing losses: for example, proper amounts of meat and cheese to preslice, techniques to slice products for maximum usage, temperatures at which to maintain coolers, proportions to use in preparing salads and hot foods, and techniques to keep foods warm and ready for consumer purchase.

Other operational factors in the deli may also influence the extent of shrink/loss. First, ordering, for example, is a delicate task. Sufficient product must be available in inventory to meet all potential sales demand without building excess inventories of highly perishable products, which ultimately lead to further losses. Second, whether certain foods (e.g., salads) are prepared in-store, in a central commissary or by an outside vendor generally has a major influence on losses. Yet all three methods are currently employed by different firm types. Some deli executives observed that a greater opportunity for waste and loss exists when preparation is performed at store level. They point out that losses occur from (1) the preparation of small batches, (2) the use of part-time labor which tends not to be as efficient as full-time employees and (3) equipment that is often not optimally employed. These companies feel that central commissary preparation or the purchasing of products from an outside manufacturer permits at the same time a more consistent product and also substantially cuts shrinkage and loss at store level. For them, preparation of foods in bulk form at one central location provides more efficient manufacturing. This is essentially an "economies of size" argument. Several deli executives pointed also to the superior headquarters' control that results with a centralized system of deli product preparation and packaging.

However, other deli executives argue that in-store preparation allows them to offer the freshest products available. Furthermore, in-store preparation generally provides the opportunity to make better use of otherwise wasted items such as meat and cheese ends, surplus barbeque ribs, and day old breads as ingredients in other deli prepared foods. Thus, according to this second scenario, in-store preparation may not only assist in reducing losses in the deli department, but may also help to combat losses in other departments such as the bakery and produce. Finally, several advocates of in-store preparation pointed to the additional merchandising creativity that this approach allows.

Pricing Practices

Pricing policies and practices for deli products, including establishing gross margins, is usually the responsibility of the deli buyer/merchandiser, or director, at the supermarket headquarters. The deli buyer/merchandiser also selects weekly advertised items and establishes the feature price for these items. This study, however, points to a fundamental difference in how prices and advertisements are determined in the deli relative to other departments in the store. Most deli executives reported "variety" and "quality" as the emphases in their weekly deli ads, while "price" tends to be the dominant criterion in the self-service grocery department.

Surveys for this study indicate that consumers are not strongly motivated by price in their purchase decisions. For example, "quality of the product" was the most frequent response given by consumers regarding the factor most important in their decision to purchase items from the deli. When shoppers who had purchased boiled ham from the deli during the last month (45 percent of all deli shoppers) were asked to estimate its price, only 28 percent were able to do so within 10 percent of the actual retail price. Finally, 50 percent of all consumers surveyed stated that they would be willing to pay more if a higher quality deli product became available.

Perhaps because of a tendency for many supermarket firms to place more emphasis on quality than on price for their deli purchases, there is generally a strong perception among both deli managers and consumers that deli products are higher in price than comparable items in the self-service meat or dairy case.

Several reasons can be put forth to explain these perceptions. Although most deli employees did not know specific prices in the self-service department, they generally assumed that deli products were higher priced. It is likely that their perception of higher prices in the deli is strongly influenced by the recognized differential in gross margin between deli products and self-service meat and cheese items. That is, because the gross margin is almost always higher in the deli department (approximately 44 percent) than in the self-service cases (approximately 28 percent), a higher price perception is apparently also established.

However, deli management may overlook that the supplier cost of the bulk product for the deli is generally lower than the cost of individually packaged items of similar weight and quality in the self-service case. Therefore, although deli gross margins are generally higher than the self-service cases in order to cover the greater service and shrinkage components inherent in the deli, the lower initial product cost of deli items often results in retail deli prices that are not higher than the comparable prepackaged items. Although deli margins may be higher, the ultimate retail price may be lower than the similar prepackaged item (see hypothetical example in Table 4).

Table 4

Hypothetical Pricing Structure for a Deli and Comparable Prepackaged Product

	Deli Product	Prepackaged Product
Product cost	$ .84	$1.14
Retail Price	$1.49	$1.59
Gross margin ($)	.65	.45
Gross margin (%)	44%	28%

Source: Cornell Survey, 1985

Table 5

Price Comparison of Cheese and Meat Items Sold in Both the Deli and Self-Service (Prepackaged) Departments*

	Deli Price Highest	Prepackaged Price Highest
	- percent -	
Meats		
Boiled Ham	22	78
Beef Bologna	81	15
Turkey Breast	51	37
Cheeses		
American	70	30
Swiss	78	22
Mozzarella	63	33
Provolone	37	33
Muenster	55	30

* Not all product category percentages add to 100 due to the unavailability of certain comparisons.

Source: Cornell Survey, 1985

Consumer perceptions, on the other hand, of higher prices in the deli can at least partly be explained by the accompanying perception that deli products are higher in quality than prepackaged counterparts. A large majority (approximately 80 percent) of consumers interviewed reported that deli quality is superior to the self-service cases. Moreover, consumers apparently reason that the additional service available in the deli must cost more.

In order to more closely examine price differentials between departments, this study compared the average prices of selected meats and cheeses in the deli with comparable brands or quality in the prepackaged self-service meat and cheese cases. Data were selected from 26 supermarkets representing 20 different companies. Results reveal that deli prices were not universally higher. In fact, of the three meat items included in the survey (boiled ham, beef bologna and turkey breast), boiled ham from the deli, per pound, was priced lower than its prepackaged counterparts in 78 percent of the comparisons (Table 5). Turkey breast prices were lower in 37 percent of the delis, and beef bologna was priced lower than prepackaged beef bologna in 15 percent of the stores (Table 5). When cheese items sold in the deli and the self-service dairy case were compared, average deli prices were found to be lower than prepackaged cheese prices, approximately 30 percent of the time (Table 5). These data are in sharp contrast to the strong "price perception" of both consumers and deli executives in this study that meat and cheese prices were always higher in the deli.

This paper summarizes selected results of the first phase of a national investigation of economic and management issues in the food store delicatessen. Phase Two of this research envisions further quantification and analysis of data describing the structure and operations of contemporary food store delis for use by food and deli industry management, researchers and public policy makers.

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